BLUEPRINT FOR REFORM:

The Report of the Task Group on Regulation of Financial Services

July 1984

BLUEPRINT FOR REFORM:

The Report of the Task Group on Regulation of Financial Services

Washington, D.C.
July 2, 1984

For sale by the Superintendent of Documents, U.S. Government Printing Office
Washington, D.C. 20402

THE VICE PRESIDENT
WASHINGTON

September 24, 1984

The President
The White House
Washington, D.C.

Dear Mr. President:

As Chairman of the Task Group on Regulation of Financial Services I am pleased to transmit its Final Report on reform of the federal financial regulatory system.

For more than a year the Task Group reviewed recommendations from its member agencies and the public. Our goal was to develop practical proposals to strengthen the effectiveness of federal regulation, while also encouraging competition and reducing unnecessary costs.

Many points of view were represented in the Task Group, and there were initial differences of opinion on many issues. However, I am proud that the members of the Task Group reached unanimous agreement on a comprehensive plan to improve the system. I am also pleased that our effort was accomplished entirely with existing staff and without any special funding.

Entitled Blueprint for Reform, the report sets forth more than four dozen recommendations. While not addressing every problem area, the report does propose realistic steps to simplify the system and to improve agency accountability. If enacted by Congress, the result will be a system better able to protect the integrity and stability of our financial markets in future decades.

In our view, the public would significantly benefit from a reorganization of our federal regulatory system. Safety, fairness and efficiency are attributes that the public interest demands of our financial system, and our recommendations are designed to help achieve these goals. We hope that you will favorably review them and authorize the introduction of necessary legislation with the Administration's strong support and the highest legislative priority.

Sincerely,

George Bush

George Bush

Table of Contents

INTRODUCTION

In December of 1982, the Task Group on Regulation of Financial Services (the "Task Group") was created to review the current federal system for regulating financial services and to propose any desirable legislative changes. The Task Group was chaired by Vice President George Bush, with Secretary of the Treasury Donald T. Regan as Vice Chairman. The Task Group's other members included the Attorney General, the Director of the Office of Management and Budget, the Assistant to the President for Policy Development, the Chairman of the Council of Economic Advisors, the Chairmen of the Federal Reserve Board ("FRB"), Federal Deposit Insurance Corporation ("FDIC"), Federal Home Loan Bank Board ("FHLBB"), Securities and Exchange Commission ("SEC"), Commodity Futures Trading Commission ("CFTC") and National Credit Union Administration ("NCUA"), and the Comptroller of the Currency.[1] Richard C. Breeden, Deputy Counsel to the Vice President, was Staff Director for the Task Group.

The American financial market is the central nervous system of the economy. Its health and vitality have a direct impact on the international competitiveness of American products, as well as on the level of domestic economic activity. In addition, virtually every consumer and community is directly affected by the availability and cost of financial services. With over 50,000 financial firms managing more than $5 trillion in private assets, financial services is also a major industry in its own right.

The complexity of U.S. financial markets is matched by that of the financial regulatory system. Financial firms or transactions are subject to an exceedingly complex jurisdictional web in which authority is shared among seven primary federal regulatory agencies, hundreds of state and local agencies, and many special purpose organizations.

The federal regulatory system had a modest beginning when the Office of the Comptroller of the Currency was created under President Abraham Lincoln to establish a new system of national banks. President Lincoln's first Comptroller began chartering and regulating national banks in 1863 with a staff consisting of five clerks and a messenger. There is still only one Comptroller, but the seven federal financial agencies now have over 38,000 full time employees, approximately 15,000 of whom are engaged in regulating financial firms or related support activities. Indeed, the OCC, FRB and FDIC together have more than 7,000 full time employees regulating banks, and they spend more than $2 billion every decade just in examining banks.

This complex system has grown piece by piece for more than six generations, and it has never been comprehensively overhauled. As a

---

[1] The Office of the Comptroller of the Currency ("OCC") is an agency within the Treasury Department, while the other six regulatory agencies are "independent" to varying degrees.

result, there is significant overlap and duplication in the responsibilities of the agencies. For example, five different federal agencies handle each of antitrust issues and securities matters involving banks and thrift institutions. Similarly, two different agencies regulate state-chartered banks, even though all such banks are generally equivalent from a federal regulatory perspective.

In addition to creating areas of duplication among agencies, the current system also subjects many financial organizations to simultaneous regulation by two or more federal agencies. For example, a national bank and its parent holding company represent a single business organization, yet that organization is supervised by both the OCC and the FRB, as well as the SEC with respect to securities disclosure. For the private firm, such a situation can result in the need to satisfy two different sets of rules, field personnel, legal interpretations and so on. This problem is intensified when agencies disagree over their own authority or impose inconsistent requirements. However, because all of the financial agencies are "independent" of direct Executive Branch authority except for the OCC, there is no effective mechanism for coordinating and harmonizing the activities of multiple agencies.

This fragmentation can impair the effectiveness of the regulatory system in maintaining safety and soundness, especially where ultimate responsibility for a particular problem is not clearly identified. Impairment can also occur where the need to coordinate actions among too many different agencies and their field offices delays effective supervisory action. In short, the structure of the regulatory apparatus may in some cases make effective supervision more difficult, as well as result in unnecessary costs for regulated firms that are passed along to the consumer.

Another serious problem results when regulatory programs create artificial advantages or disadvantages for particular types of competitors. This can easily happen when banks, insurance companies, securities firms or other types of concerns compete in the same product area but are not subject to a common set of regulatory requirements administered by a single agency. Ideally any particular firm should be successful because it offers consumers the best services and prices, not because of quirks in the maze of legal restrictions that give it an artificial advantage over different types of competing firms.

Additional unnecessary costs result from the fact that at present some simple, everyday activities are subjected to regulatory proceedings that serve no apparent purpose. Regulations also contribute to extensive and highly costly litigation. As both regulatory and legal costs are ultimately paid for by the consumer, there is a significant public interest in eliminating those that are unnecessary or counterproductive.

Finally, the existing system is designed as a "dual" federal and state system for regulating depository institutions. Over the years, state regulatory programs have proven invaluable in creating the flexibility to experiment with new products or services. Often Congress has extended new forms of service nationwide only after one or more states have acted as a laboratory for innovation and demonstrated the value to the public of a new idea. Maintaining the freedom of states to experiment with new ways of serving the financial needs of the public, while maintaining essential safety and soundness considerations, is a vital ingredient in ensuring the availability of the widest variety of products at the lowest possible cost.

Approximately 70% of all banks (and over 50% of thrifts) are chartered, examined and regulated by the states. However, virtually all these firms are also subject to at least one federal agency because of federal deposit insurance or membership in the Federal Reserve System. Unfortunately, in many cases the federal agencies duplicate regulatory activities performed by the states, often in areas unrelated to maintaining a stable financial system. This creates unnecessary costs and may discourage the states from playing a more active role in the regulatory system.

The Task Group is not the first group to review many of these issues. In fact, previous studies have proposed consolidation or reorganization of the federal financial agencies throughout the postwar era. However, the Task Group was <u>not</u> established to do yet another academic study. Instead, the Task Group's objective was to consider the many different alternatives proposed by previous groups, the agencies and the public in order to develop a specific set of workable proposals for action.

Utilizing existing staff and resources, the Task Group spent more than a year reviewing the current system to determine if it serves the public interest as well as possible in light of the numerous changes in financial markets in recent years. The Task Group considered the goals of federal regulation, various specific problems that have developed under the existing system and a wide variety of possible changes to strengthen and improve the system. Throughout its work the promotion of the public interest was the cardinal objective, rather than the interest of any particular agency or industry.

This Report reflects the conclusions of the Task Group members regarding many difficult problems. It includes more than four dozen specific recommendations for legislation to improve the existing system. These recommendations would reduce overlap and duplication among the regulatory agencies and eliminate many unnecessary regulatory burdens. At the same time, however, prudent checks and balances would be maintained, and in some respects strengthened, to help insure a consistently safe and sound financial system.

Each of the Task Group's recommendations was unanimously adopted. Together, they form a balanced and workable program for reorganizing and streamlining the existing federal financial regulatory system. As such, the recommendations were designed as an interdependent set of proposals that should be considered as a whole.

The general description of the current system contained in Part I and the summary of major changes proposed by the Task Group reflect a general consensus of the Task Group members. However, each individual member may not fully agree with every statement contained therein. Therefore, the signatures of the Task Group members should be regarded as an affirmation of the specific recommendations of the Task Group and the general principles set forth in the Report.

Overview of Recommendations

The overall objective of the Task Group recommendations is to achieve the best possible balance of three essential goals:

- safety and soundness,
- consumer protection, and
- competition and efficiency.

To help achieve these goals the Task Group proposals seek to strengthen the regulatory system by simplifying it and improving accountability. No agency would be eliminated, but agency responsibilities would be clarified, and the overall process would be streamlined. In some areas particular regulatory functions would be consolidated in a single agency. In others, existing regulatory programs would be modified to reduce unnecessary costs. Major changes in the structure of federal bank regulation would also be implemented to increase efficiency and improve the reliability and flexibility of the system.

Key points of the proposals include:

-- The three existing federal bank regulators would be reduced to two by eliminating the FDIC's role in examining, supervising and regulating state non-member banks. A new "Federal Banking Agency" ("FBA") would be created within the Treasury Department, incorporating and upgrading the existing OCC. This agency would regulate all national banks, while the FRB would be responsible for federal regulation of all state-chartered banks.

-- The regulation of bank holding companies would be substantially reorganized. At present, the FRB regulates all bank holding companies, even though a different agency usually regulates the subsidiary bank(s) of the holding company. Under the new system in almost all cases the agency that regulates a bank would also supervise its parent holding company. This would make it possible for most banking organizations to have a single federal regulator rather than two.

-- The FRB would transfer its authority to establish the permissible activities of bank holding companies to the new FBA, although it would maintain a limited veto right over new activities.

- The FRB would continue to supervise the holding companies of the very largest domestic banks, as well as those with significant international activities and foreign-owned institutions.

- The FDIC would be refocused exclusively on providing deposit insurance and administering the deposit insurance system. All its current responsibilities for environmental, consumer, antitrust and other laws not directly related to the solvency of insured banks would be transferred to other agencies, as would its responsibilities for routine examination, supervision and regulation of state non-member banks. At the same time, the FDIC would assume new authority to review issuance of insurance to all institutions, as well as to examine all troubled institutions and sample non-troubled firms in conjunction with the primary supervisor. The FDIC would also have new authority to take enforcement action against violations of federal law concerning unsafe banking practices in any bank examined by it where the primary regulator failed to take such action upon prior request of the FDIC.

- A new program would transfer current federal supervision of many state-chartered banks and S&Ls (and their holding companies) to the better state regulatory agencies, creating new incentives for states to assume a stronger role in supervision.

- The special regulatory system for thrifts would be maintained, but eligibility would be based on whether an institution is actually competing as a thrift, rather than on its type of charter.

- The FDIC and FSLIC would be required to establish common minimum capital requirements and accounting standards for insurance purposes.

- Antitrust and securities matters would each be handled by a single agency rather than five different agencies at present.

- Some specific regulatory provisions would be simplified to eliminate unnecessary burden. These include existing legislative provisions that encourage wasteful litigation, as well as outdated application requirements in various areas that result in substantial unnecessary paperwork.

Needless to say, the proposals of the Task Group would not guarantee either good management by financial firms, or consistent and effective leadership of the financial regulatory agencies. However, these proposals would strengthen our ability to maintain a safe and sound financial system. At the same time they would also begin to reduce many of the unnecessary costs and burdens of the current system. As a comprehensive package the proposals would represent the most significant overhaul of our federal regulatory aparatus since the 1930s. Their adoption would produce substantial and lasting benefits for both our financial markets and the American public.

Members of the Task Group

George Bush
Chairman
Vice President of the
United States

Edgar Callahan
Chairman, National Credit
Union Administration

Susan M. Phillips
Chairman, Commodity Futures
Trading Commission

C. Todd Conover
Comptroller of the Currency

John S. R. Shad
Chairman, Securities and
Exchange Commission

Martin S. Feldstein
Chairman, Council of
Economic Advisers

William French Smith
Attorney General of the
United States

Edwin J. Gray
Chairman, Federal Home Loan
Bank Board

David Stockman
Director, Office of
Management and Budget

William M. Isaac
Chairman, Federal Deposit
Insurance Corporation

John A. Svahn
Assistant to the President
for Policy Development

Paul A. Volcker
Chairman, Board of Governors of
the Federal Reserve System

Donald T. Regan
Vice-Chairman
Secretary of the Treasury

THE TASK GROUP STAFF

RICHARD C. BREEDEN
Staff Director and
Deputy Counsel to the
Vice President

CHRISTOPHER DeMUTH
Administrator, Office
of Management and Budget

JULIA A. GOULD
Special Assistant to the
Chairman, Federal Home
Loan Bank Board

MARSHALL E. HANBURY
Executive Assistant/Counsel
to the Chairman,
Commodity Futures Trading
Commission

THOMAS J. HEALEY
Assistant Secretary of the
Treasury for Domestic Finance,
Treasury Department

EUGENE J. McALLISTER
Deputy Assistant Director
for Economic Affairs,
Office of Policy Development,
The White House

WILLIAM POOLE
Member, Council of Economic
Advisers

STEVEN M. ROBERTS
Assistant to the Chairman,
Board of Governors of the
Federal Reserve System

ALAN ROSENBLAT
Assistant General Counsel,
Securities and Exchange
Commission

CHRISTIE A. SCIACCA
Assistant to the Deputy
to the Chairman, Federal
Deposit Insurance Corporation

WENDELL SEBASTIAN
General Counsel, National
Credit Union Administration

H. JOE SELBY
Senior Deputy Comptroller
for National Operations,
Office of the Comptroller
of the Currency

J. MICHAEL SHEPHERD
Special Assistant, Office of
Legal Policy, Department
of Justice

LORRAINE M. HAMBLIN
Executive Secretary

PART I: THE FEDERAL FINANCIAL REGULATORY SYSTEM

I. Overview of the Federal System

A. Existing Regulatory System

The financial services market of the United States is unique throughout the world due to its size, its diversity among different types of firms and the complex range of products and services that are available. Over $5 trillion in private financial assets are handled by over 50,000 different firms, ranging in size from small credit unions with a few hundred dollars in assets to the largest banks with well over $100 billion in assets. Together, the financial services industry is a major sector of the American economy, and in the aggregate it accounts for approximately 15% of the annual gross national product. Of course the significance of the financial services industry is even greater than its share of GNP, as the financial system in a very real sense serves as the central nervous system of our overall economy.

Aside from its national significance, the most striking fact about the financial services industry is its diversity among different sizes and types of firms. Figure 1 shows, as of December 31, 1983, the relative market share of various different types of financial firms. At that time, commercial banks collectively held approximately 35% of aggregate financial assets, representing the largest single industry group in terms of market share. Thrift institutions represented the second largest group, with approximately 20% of aggregate assets, while insurance companies followed close behind with approximately 17% of total assets.

Like the financial marketplace, the current federal financial regulatory system is complex, with seven primary and numerous secondary federal regulatory agencies[2] operating through a maze of interrelationships that can fairly be described as labyrinthine. The seven federal agencies (which regulate many, but not all, of the different types of firms providing financial services) are the OCC, FRB and FDIC for banks, the FHLBB for thrifts, the NCUA for credit unions, the CFTC for commodities and futures firms and the SEC for securities firms. Insurance companies, mortgage brokerage firms and other providers of financial services are not directly regulated by the federal government.

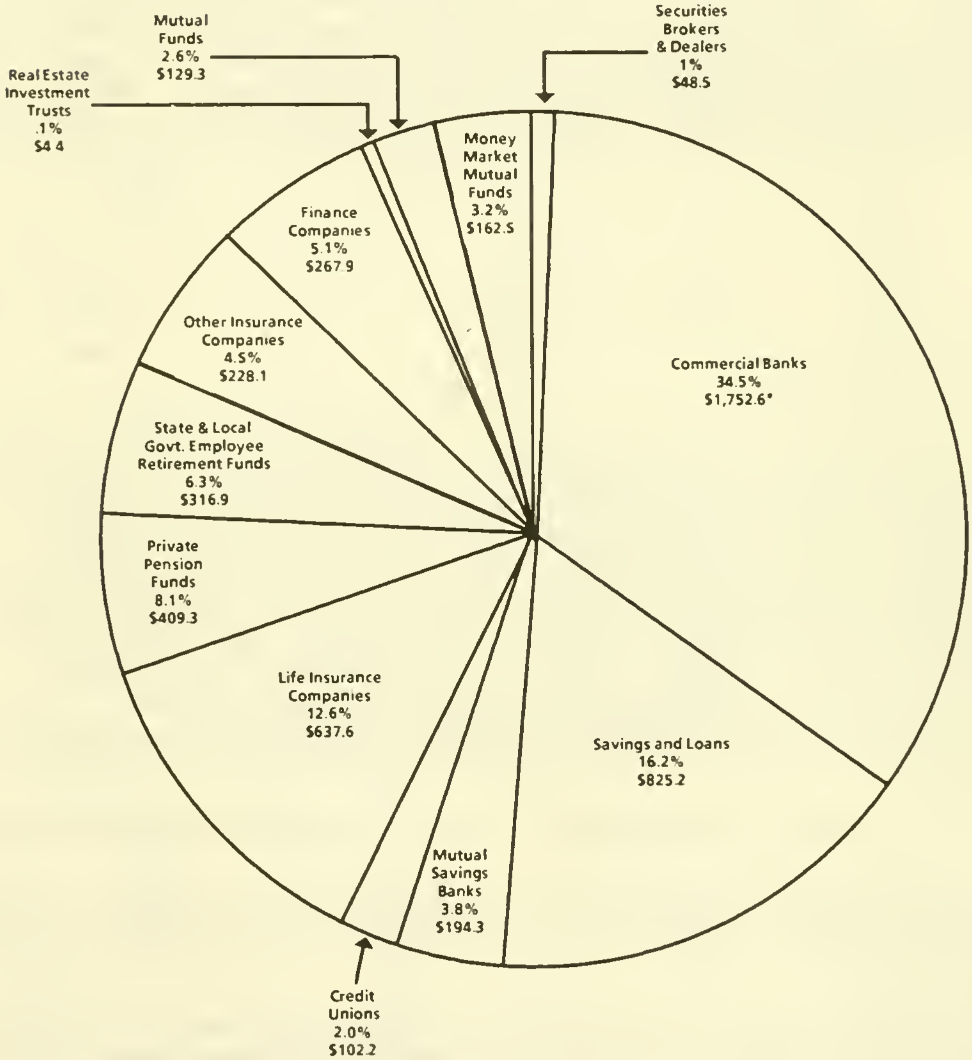
The federal financial agencies that were members of the Task Group (including the district Federal Reserve Banks and Federal Home Loan Banks) employ over 37,000 personnel on a full time basis. Of this total, approximately 15,000 are engaged in activities related to the regulatory role of these agencies, while the remainder are engaged in a variety of activities (such as check processing or formulation of monetary policy)

---

[2]The "primary" regulatory agencies were all members of the Task Group. "Secondary" agencies would include agencies such as the Department of Housing and Urban Development or Small Business Administration which affect the financial markets directly through loan or guarantee programs or otherwise, but which do not directly supervise financial institutions.

FIGURE 1

Total Private Financial Assets
Percent Held by Different Financial Service Firms
(As of 12/31/83; $ in billions)



Total Assets: $5,078.8 Billion

* This figure does not include international banking facilities, and it is net of interbank liabilities.

not related to supervision or regulation.[3] The aggregate fees, assessments, interest income or appropriations of these agencies exceed $4 billion annually (excluding the earnings of the Federal Reserve Banks and the Federal Home Loan Banks).[4] In 1982 the seven agencies imposed over 58.9 million hours of annual paperwork on the private sector, representing 4.1% of the non-IRS annual paperwork of the entire federal government.

Under the current system, regulation of the nation's more than 14,000 commercial banking organizations[5] is divided among the OCC, FRB, and FDIC, state agencies, the SEC and the Justice Department as shown in Figure 2. Banks with a national charter are regulated by the OCC. State-chartered banks that are members (state "member" banks) of the Federal Reserve System are regulated both by the FRB and their state regulator. State-chartered banks that are <u>not</u> members of the Federal Reserve System (state "non-member" banks) are regulated both by the FDIC (if they are federally insured)[6] and by their state supervisory agency.

---

[3]The Federal Reserve System is the largest of the agencies, with more than 24,000 employees on a full time basis. However, the great majority of its personnel are engaged in functions unrelated to direct supervision or regulation, such as check clearing. Indeed, for calendar year 1983 the Federal Reserve System had an estimated 2,148 full time personnel engaged in bank supervision or regulation. For the same period the estimated employment for the other financial agencies was: OCC - 2,815; FDIC - 3,475 (including more than 1,100 employees in its liquidation function); FHLBB (including Federal Home Loan Banks) - 3,816; NCUA - 672; CFTC - 490; and SEC - 1,912.

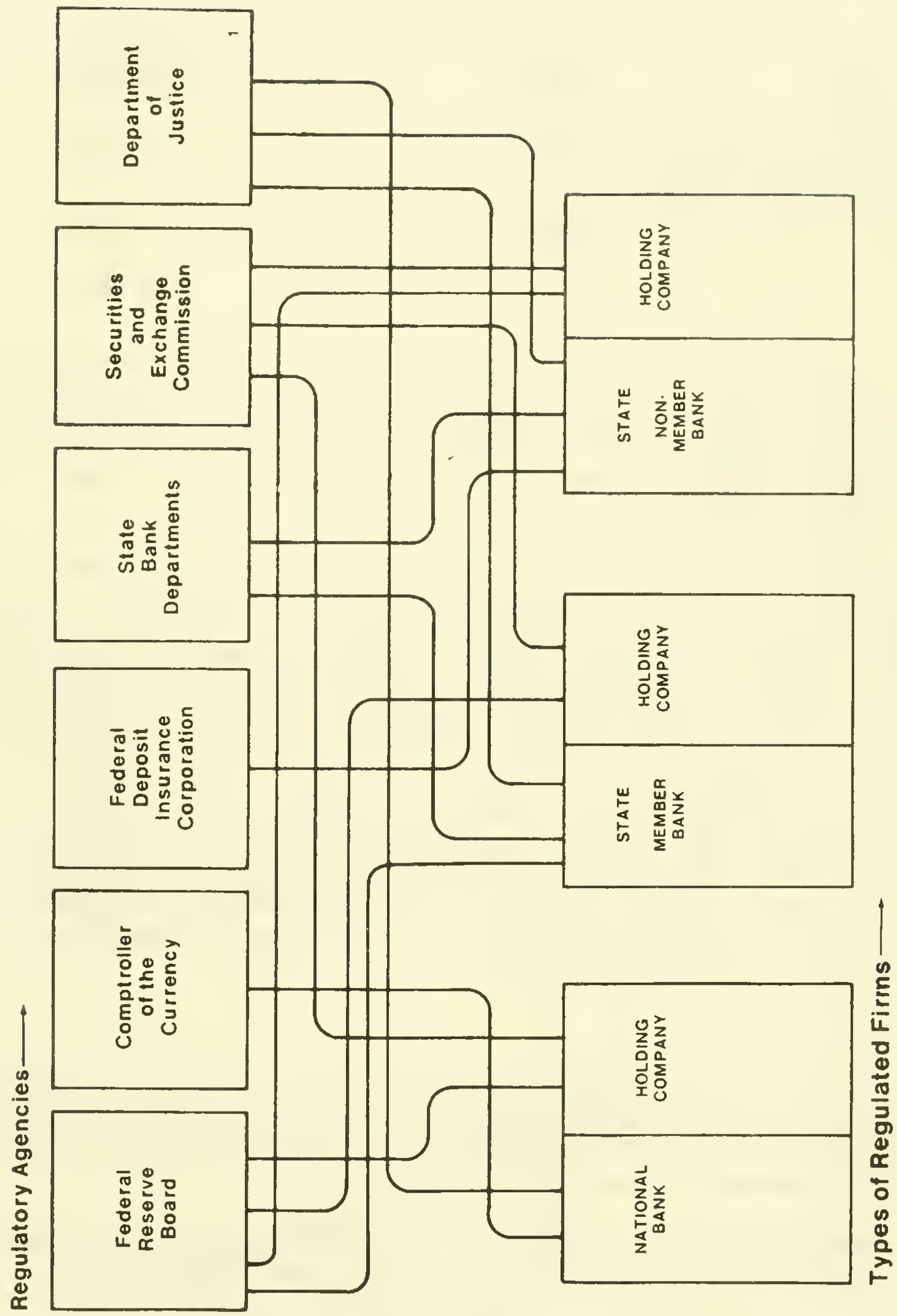
[4]See Figure 13 of Appendix A for a breakdown of funding by agency.

[5]Some banks are owned directly by their shareholders. In a majority of cases, however, the bank is a subsidiary of a holding company owned by the shareholders.

[6]Most (but not all) commercial banks are insured by the FDIC. Insurance is mandatory for national and state member banks, but remains optional for state non-member banks. Most mutual savings banks (a state-chartered thrift institution) are also regulated by the FDIC. In addition, in 1982 state-chartered "industrial banks" became eligible to join the federal deposit insurance system, which some such institutions have done. Although they possess different characteristics, these institutions are included under the rubric of "commercial" banks. To date these institutions have generally been quite small in size, averaging $5-10 million in total assets.

FIGURE 2

EXISTING REGULATION OF BANKS AND THEIR HOLDING COMPANIES



1 Antitrust Enforcement only

The number and respective asset share of the three different types of banks is shown below:

Distribution of Commercial Banks by Number and Assets[7]
(As of 12/31/83)

Type	Number	% of Banks	Assets (in billions)	% of Total Bank Assets
National Banks (OCC)	4,772	33%	$1,400	60%
State Member Banks (FRB)	1,059	7%	$426	18%
State Non-Member Banks (FDIC)	8,632	60%	$516	22%
Total	14,463	100%	$2,342	100%

The vast majority of banks are small institutions, with only a few hundred very large banks. In fact, over 80% of banks have $100 million in assets or less, with over 40% having $25 million or less in assets. The number and size pattern of bank holding companies follows that of individual banks.[8]

Regulation of banks is, however, only one of two layers of federal supervision, as federal controls also exist for the parent holding companies of banks. Although it was originally limited to a very small number of firms, in recent years the number of banking organizations utilizing the holding company form of organization has grown rapidly. As shown on Figure 3, the number of registered holding companies rose from only 53 in 1956, when the Bank Holding Company Act ("BHCA") was enacted, to almost 5,400 at year-end of 1983. In fact, over the last 15 years the holding company form of organization has grown from relatively limited use to become the dominant organizational form of U.S. banking companies, with well over half of all U.S. banks now owned by holding companies. Under current law the FRB regulates all bank holding companies in the United States, even though in most cases it does not regulate the subsidiary bank or banks of such firms.[9]

---

[7]This chart shows commercial banks only. If mutual savings banks regulated by the FDIC were included, the number of firms regulated by the FDIC would rise to 8,925, with $686 billion in assets, or 27% of aggregate commercial and savings bank assets.

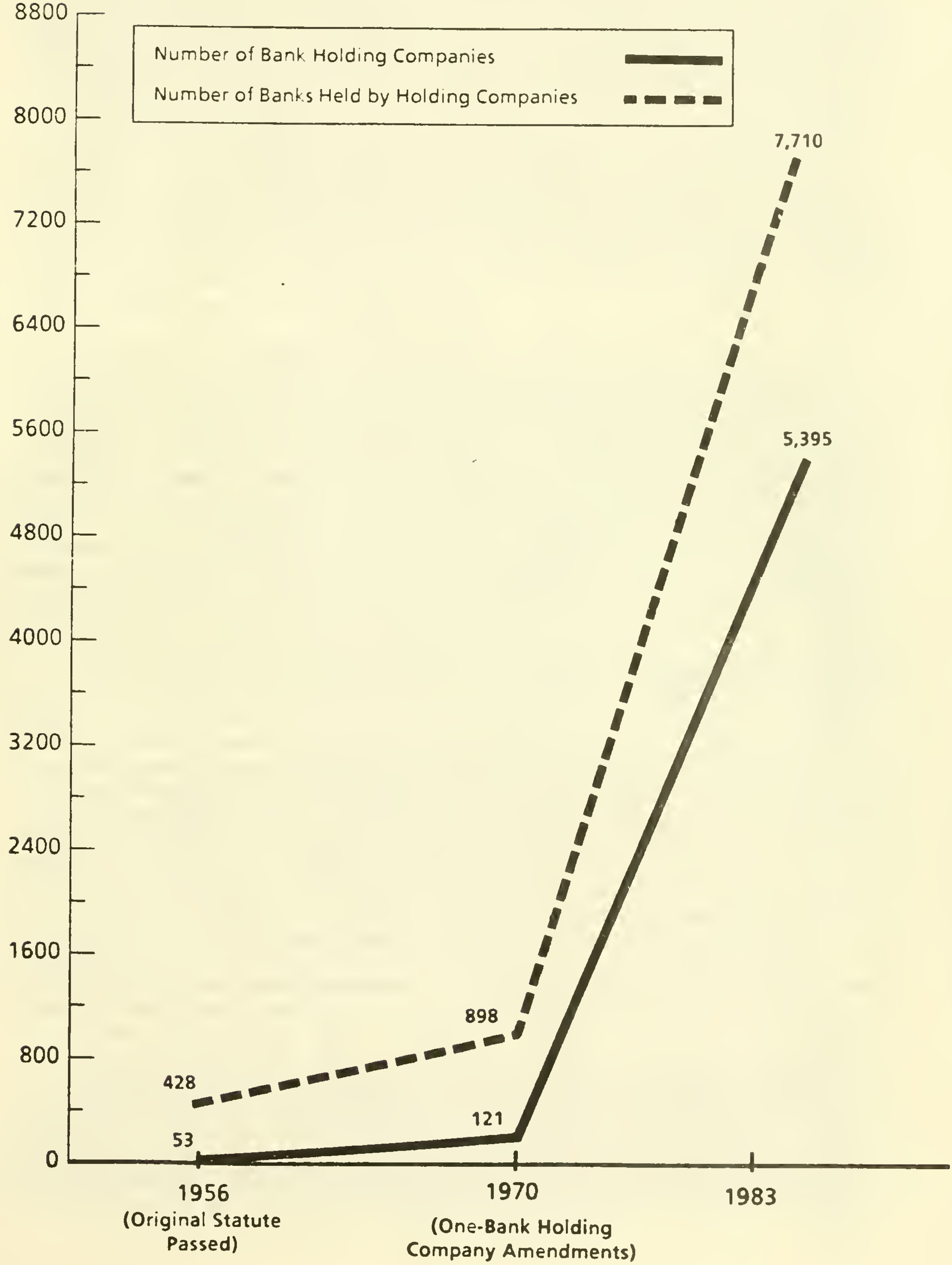
[8]See Figures 14, 17 and 18 in Appendix A for the distribution of banks and their holding companies by type and size.

[9]There are both "one-bank" and "multi-bank" holding companies, although since the 1970 amendments to the Bank Holding Company Act there has not been any regulatory difference between the two.

FIGURE 3

Growth of Bank Holding Companies and Banks Held by Holding Companies

(as of 12/31/83)



Like banks, there are several categories of thrift institutions.[10] However, except for a small number of state-chartered savings banks regulated by the FDIC, all thrifts are regulated by the FHLBB. There are a total of approximately 3,500 thrift institutions, and thrifts had 30% of total bank and thrift assets as of December 31, 1983.[11] Thrifts and their holding companies are more evenly distributed according to size than banks. Also unlike banks, few thrifts are organized in holding company form.[12] Like banks there are two different types of thrift holding companies, but unlike the bank system "unitary" and "multiple" thrift holding companies operate under substantially different regulatory restrictions. Numerous other regulatory differences exist between banks and thrifts, as well as between depository and non-depository firms.

---

[10]"Thrift institutions" and "thrifts" are generic terms that include several different types of Federal or state-chartered institutions originally designed to promote thrift or savings by ordinary citizens. Savings and loan associations (almost evenly divided between state and federal charter) comprise over 91% of the number of thrift institutions, and hold approximately 81% of aggregate thrift assets. Mutual savings banks represent the other basic category of thrift institution, and as of year-end 1983 they held approximately 19% of total thrift assets. Prior to the Garn-St Germain Act of 1982 there were no federally-chartered savings banks, as the FHLBB did not have authority to issue any charters other than for savings and loan associations. The state-chartered mutual savings banks have assumed a variety of different forms (and names) in different states, and the states have been issuing savings bank charters for over 100 years. By year end 1983 there were 143 savings banks operating under federal charter.

[11]See Figures 15 and 16 in Appendix A for the distribution of assets among different types of thrift institutions and for all banks and thrifts combined. As of December 31, 1983 thrift institutions had aggregate assets of $988 billion, compared with approximately $2.3 trillion for commercial banks. The total number of thrift institutions has fallen significantly in recent years. Indeed, the number of members of the Federal Home Loan Banks has declined from a peak of 5,053 in 1965 to only 3,407 at year end 1983. This represents a reduction of over 33%, with a 20% drop in the number of such institutions since 1980 alone.

[12]This is largely attributable to the very large percentage (approximately 75%) of thrift institutions that have traditionally been organized in the mutual form of ownership. Another factor is the traditionally broad investment powers of thrift service corporations which have been utilized instead of holding companies for engaging in a wide range of financial, and non-financial activities. As thrifts convert from the mutual to stock form of ownership, which is occurring in increasing numbers, the use of thrift holding companies can be expected to increase significantly. The distribution of thrifts and their holding companies by asset size is shown in Figures 19 and 20 of Appendix A.

B. The Impact of Deregulation on Financial Institutions

During recent years American financial markets have seen significant experimentation with new products and services, the emergence of a large number of new competitors that have not been historically associated with traditional financial activities and numerous combinations among previously distinct types of financial firms. The pace of change has been rapid, and evolution in the marketplace does not appear to have ended.

Many of the changes that have occurred stem from changes in our underlying economy associated with inflation and the resultant higher level of interest rates that have affected the way consumers and businesses manage their financial assets. Higher interest rates and changing technology have, perhaps more than any other factors, created new market needs and opportunities that were unknown when the basic federal legislative structure was enacted decades ago.

With an increased awareness among consumers and businesses of the profits that can accrue from effective management of funds, the previous system of interest rate ceilings on depository institutions became untenable. At an increasingly rapid pace as market rates increased, consumers and businesses moved hundreds of billions of dollars from depository institutions to instruments offering market rates of return. In addition, the application of these ceilings seriously discriminated against savers of ordinary means, who were denied an opportunity to receive market rates while rates for large savers were never limited by federal controls. As a result, federal controls on interest rates for time deposits[13] have been largely eliminated through a series of legislative and regulatory steps over the past few years.

Thus the liability side of depository institution balance sheets has been largely "deregulated," although bank and thrift institutions remain some of the most extensively regulated businesses in America. Extensive controls remain on the types of financial and other products which such firms may offer, the locations at which they may operate, interest rates they may charge customers (established by the various states), mergers or acquisitions involving such firms and many, many other areas. Thus, while interest rates have been decontrolled, our banking system as a whole has not been "deregulated."

Some analysts believe that in the future financial services companies will offer an increasingly wide array of customer services. Certainly several leading financial institutions have already moved substantially in this direction. As another example of this trend, some

---

[13] It continues to be unlawful to pay interest on demand deposits, such as traditional checking accounts maintained by small businesses and consumers. The time value of funds in such accounts is at least partially compensated through payment of "implicit" interest in the form of lower service charges, free or low cost accounts or other benefits to depositors.

observers note recent legislation that has substantially broadened the powers of thrift institutions and suggest that in the future these entities will become substantially similar to commercial banks. In addition, Congress is considering Administration-sponsored legislation to reduce the current restrictions on the types of financial products that may be offered by bank holding companies. Removal of current restrictions against bank competition in various financial product areas would permit the further development of broader-based financial institutions combining banking and other financial services.

While it is impossible to predict with certainty the future structure of the markets for financial services, some observers disagree that the financial services industry will be characterized by commonality or homogenization. These observers cite the enormous and rich diversity of our population, communities and regions, and argue that a responsive and competitive financial services industry will continue to reflect both historic industry developments and the continuing variety of financial needs in the nation. Inter-industry competition will continue and should be encouraged, according to this view, but while some firms will provide the "supermarket" spectrum of services, many if not most firms will continue to concentrate their activities in one or more specialized geographic or product areas.

In addition to the differences of opinion concerning the shape of future markets, there is also a significant divergence of views concerning the role government should play in this process. In the five decades since the 1930's, federal government policy has been largely interventionist, imposing restrictions on financial markets to limit entry, control prices and establish and maintain relatively rigid and artificial forms of market segmentation. Federal controls on interest rates and legislative creation of various areas of restricted competition (through statutes such as the Glass-Steagall Act) helped to stabilize the chaotic marketplace conditions that followed the stock market crash of 1929 and the wave of bank failures that occurred over the succeeding few years. However, many observers also believe these actions were more restrictive of competition than necessary to protect safety and soundness.

One result of unnecessary restrictions on financial competition is that consumers are forced to, in effect, subsidize financial services firms or other customers (e.g. depositors subsidizing borrowers in the case of thrift institutions under interest rate controls). Nevertheless, many observers believe strongly that the Federal government should overrule the free market to achieve a variety of policy objectives, such as decentralization of the financial system, even if the result may be higher prices for the public and a less efficient financial system.

Other observers believe that competitive forces rather than government agencies or laws should be allowed to structure the marketplace. In this view unrestrained entry into financial services markets will produce efficient markets, free of the distortions and inefficiencies that are usually created by government attempts to organize market activity. Many of these observers believe that the appropriate focus of government should be to promote efficient, competitive markets by prohibiting negative practices (such as monopolization, fraud, inadequate disclosure or capitalization, etc.). According to this view, social priorities (such as providing residential home financing, reinvestment in declining urban areas or other examples) would best be achieved by creating direct incentives through the tax system rather than through indirect and far less efficient "regulatory" inducements. These observers believe that institutions should have the maximum possible degree of flexibility to determine their own business activities in light of market conditions and competition, with government rules restricted to those necessary to prevent unfair competition and to encourage, but not require, favored types of activities.

While the precise details of the future cannot be known, three broad sets of future market changes will probably occur, and these changes are likely to be particularly relevant to questions of the federal regulatory structure.

First, most federal restrictions on pricing by depository institutions will end. Indeed, federal price controls on interest rates for time deposits have already been virtually eliminated. Because of the enormous benefits for consumers, this process can be expected to continue, including the eventual elimination of the prohibition against payment of interest on demand deposit accounts. Legislated controls on interest rates for borrowers will also presumably be largely removed to reflect the variable market rates of interest financial institutions must now pay for deposits.

Second, the distinctions between different types of depository institutions, and between depository and other financial services institutions, will continue to fade. The Garn-St Germain Act greatly expanded the bank-like powers of thrift institutions, while retaining the legal distinction of these institutions as a separate industry. This Act built upon the expansion of powers initiated by the Depository Institutions Deregulation and Monetary Control Act of 1980. Many new state laws in recent years have also significantly expanded the permissible activities of state-chartered credit unions, thrift institutions and banks. Accordingly, many of the purely legal distinctions between the traditional categories of depository institutions have disappeared, although many individual institutions will almost certainly continue to specialize in particular products or services. In addition, depositories will increasingly enter activities traditionally limited to investment banking, brokerage and insurance firms, and vice-versa.

This process has already proceeded to a significant degree both directly and indirectly. Even now, several major investment banking firms have acquired banks as affiliates by limiting the activities of these institutions in a manner necessary to avoid the definition of "bank" under federal law relating to bank holding companies. While legislation now before Congress may alter their legality, these limited purpose "nonbank banks" have also been used by banks to avoid federal restrictions against geographic diversification. Similarly, insurance companies (which are not regulated at the federal level) have, like investment banking firms, also acquired limited purpose banks, together with securities brokerage and underwriting firms and other providers of financial services. Finally, hundreds of banks have moved aggressively into the securities brokerage business through operation of "discount" brokerage facilities, which the Supreme Court has held does not violate the Glass-Steagall Act where conducted by a holding company non-banking subsidiary.

Third, depository institutions will continue to expand their geographic scope of operations through increased electronic services, expansion of subsidiary activities, acquisitions of failed institutions, changes in state laws and possibly federal regulatory changes. Indeed, some of the nation's largest banks and thrifts have already made interstate acquisitions of failing firms, while many states have passed or have under active consideration new legislation to reduce barriers against in-state and out-of-state bank competition.[14] In fact, after decades of geographic segmentation of the American banking industry, the states have now begun an extremely rapid move to interstate banking, at least initially on a regional basis. Regional reciprocal state laws have been subject to legal challenge, and they raise serious policy concerns as well. However, market realities make this trend likely to continue, even without new federal legislation, until many current geographic restraints on competition are eventually removed.

To the extent they occur the foregoing changes will tend to intensify the difficulties of the existing regulatory system in providing equitable and consistent regulatory treatment of financial institutions. They will also cause increasingly severe problems of conflicting regulatory policies and duplication, as more and more institutions become subject to multiple regulatory agencies. Without modification the current system is probably incapable of resolving the conflicts and inequities that have already occurred among financial institutions, and such problems can only be expected to worsen over time.

In sum, ongoing and prospective changes in the economic environment and the product and geographic diversification of depository institutions appear to increase the desirability of reform of the regulatory structure. Higher interest rates increase the need for consumers to manage their funds more actively, and increase the possible competitive consequences of differences in regulatory treatment of different types of firms. Product diversification may expand the non-banking responsibilities of bank regulators, such as over securities activities, to an undesirable degree. Geographic diversification may enhance the desirability of consistent substantive regulation for firms operating across state lines, as well as increasing the need for consistency among the various chartering authorities.

---

[14] As of July 20, 1984, there were 12 states (mostly in New England and the Southeast) that had passed national or regional interstate banking laws. The majority of the laws permit interstate banking on a regional, reciprocal basis only, but Maine and Alaska permit national, nonreciprocal interstate banking. Reciprocal interstate banking bills were introduced in many other states during 1984, with future enactment possible during the next few years.

In the face of potential changes to the market environment, some observers argue that existing restrictions on entry and competition in various financial businesses should be strengthened, often in the name of safety and soundness. While each separate area must be reviewed in light of its individual merits, several generalizations can be made. First, segmentation of financial markets may increase rather than decrease risks to the banking system by preventing opportunities for financial firms to diversify their earnings to reduce exposure to cyclical economic conditions. Second, arbitrary limitations on competitive activities may freeze inefficiencies and unnecessary costs into the economy, while at the same time making it harder to attract equity capital to businesses operating under the greatest restrictions. Finally, previous experience suggests that banks, securities firms and other financial firms will develop new techniques by which to evade regulations preventing economically efficient behavior. Indeed, the higher the costs of regulation become, the greater the incentive is to devise means by which to evade such restrictions. Consequently, it may be difficult if not impossible practically to prohibit efficient markets, even if it were somehow determined to be in the public interest to do so.

In response to such factors, the regulatory system can be reformed through a combination of (i) agency reorganization, (ii) transfers of regulatory authority among agencies and (iii) elimination of outdated or unnecessary regulatory controls on particular activities in order to make it more efficient, fair and effective. Indeed, with a significantly more competitive environment characterized by a variety of both specialized and diversified institutions, there will be a much greater need for a system that can flexibly accommodate new products and services and technological developments. At the same time there remains a need to provide consistency and uniformity in the regulatory treatment of financial institutions to guarantee maintenance of a safe and sound financial system.

C. Need for Regulatory Relief and Reorganization

Under the current system of Federal regulation, the type and nature of regulatory requirements varies significantly among different types of institutions. This situation has developed largely because the regulatory system developed over a long period of time in a series of piecemeal steps responding to various specific problems.

As the financial system became more complex in response to the growth of the American economy, new types of financial intermediaries and products emerged. The regulatory system was gradually adjusted to accommodate such developments, as well as in response to periodic crises or financial system difficulties. In some cases this occurred through the creation of new agencies, while in other cases it resulted in expansion of responsibilities for an existing agency. As a result, the regulatory structure can really only be explained as a result of its evolution, and the system has never been comprehensively overhauled to ensure that the various constituent parts work both coherently and efficiently.

Recent trends in the financial system as a whole have highlighted existing and potential problems with the current regulatory structure. These include:

1. Differential Treatment. As many types of institutions and the products that they offer have become more similar and come into increasingly direct competition with one another, differences in regulatory controls are much more likely to influence artificially the behavior of savers, investors or consumers. The impact of now-discontinued federal interest rate ceilings demonstrated that differences in regulatory programs alone may be sufficient to induce significant shifts of consumer behavior, and thereby to alter materially the opportunities of the competing institutions. These interest rate controls also may have had a disproportionate impact on the cost structure of depository institutions by creating incentives for such firms to develop expensive networks of branches in order to compete for low-cost deposits.

In addition to altering competitive advantages artificially, differences among regulatory agencies that have common or overlapping jurisdiction may prevent transactions that might otherwise occur or sharply increase costs that are passed along to the consumer. This can result from the need for a single firm to comply with conflicting government policies or to obtain multiple approvals from different agencies for the same transaction.

Finally, differential regulation can result in inequitable treatment of firms competing in the same market, as well as possibly differing levels of protection of the public. For example, it is fundamentally unfair to banks to permit community groups or competitors to protest the opening of a new bank office, a bank merger or a new type of holding company activity, while securities firms, insurance companies and other direct bank competitors are immune from any such proceedings. Similarly, permitting banks or thrifts to offer securities for sale to the public without registration with the SEC under the Securities Act of 1933, as required for every other type of issuing company, could result in unfair treatment of the unsuspecting investor not aware of this potential "gap" in regulatory protection.

2. Excessive Regulatory Controls. In some areas particular regulatory requirements, whether created by statute or regulations, may impose costs that far exceed any public benefits derived therefrom. For example, certain depository institutions are currently required to obtain advance regulatory approval before opening new offices, forming holding companies or engaging in other types of routine "corporate housekeeping" transactions. Many requirements for advance government approval could be abandoned in favor of automatic permission to conduct such activities, subject to veto by the appropriate regulator due to specific supervisory problems, while other approval processes could be streamlined.[15]

---

[15]For example, in calendar years 1980-82, the FDIC and FRB
(Footnote Continued)

The current system may also impose inordinately burdensome record-keeping or information collection requirements, excessive or ambiguous disclosure obligations and many other highly detailed controls which result in substantial costs to borrowers, savers or investors. Regulatory controls may be excessive both with respect to particular types of transactions (e.g. mergers or formation of holding companies), as well as basic operations of certain types of institutions (e.g. bank regulation in general). In addition to unnecessarily raising the cost of financial services to the public, excessively broad regulatory controls may reduce the effectiveness of supervisory programs by so broadening the scope of a regulatory agency's activities that it becomes difficult for the agency to fully concentrate on the really significant problems.

3. Overlap and Duplication. In some areas the jurisdictions of regulatory agencies may in fact overlap so that a single private firm is subject to concurrent regulation by two or more federal agencies. Such firms may then be forced to adhere to multiple sets of operating requirements, accounting or recordkeeping policies and reporting obligations, as well as being subjected to multiple examinations or supervisory reviews. Such duplication may consume significant employee and officer time, as well as require unnecessarily large expenditures for internal or external professional services.[16]

(Footnote Continued)
considered a total of 3,652 applications from state-chartered institutions to open branches. Of these applications, virtually all of which had already been reviewed by state regulators, only 11 were denied. This overall approval rate of 99.7% suggests that it would be far more efficient to eliminate any requirement for federal branch approval except where the appropriate agency determines that special supervisory considerations warrant imposing restrictions on a particular firm. Such a change in procedures would eliminate thousands of routine applications and their unnecessary paperwork, while preserving the government's ability to act in the exceedingly rare cases when this may be necessary.

[16]For example, a state-chartered non-member bank with a one-bank holding company is examined by the FDIC (for the bank) and FRB (for the holding company), its state regulator and its own private accountants, often all in the same year. In the aggregate, the federal financial regulatory agencies spent $237 million on examinations alone during 1982, with the three bank agencies accounting for $173 million of this total. Of course this figure significantly understates the total cost of examinations, as it does not include the expenditures of state regulatory agencies or the expenses of the firms subject to examination. As described by one bank,"1983 was a prime example of the needless duplication of examinations under the current program. In mid-April a team of state examiners spent two weeks here. In early November eleven Federal Reserve examiners spent two weeks here. In December our CPA firm did its annual 'thing'. The . . . Bank has twelve full time employees and ended 1983 with $13,000,000 in assets." That institution calculated that its expenses in connection with its 1983 examinations equalled 13% of the net income of the bank.

Probably the most prevalent examples of concurrent regulation arise in the regulation of bank holding companies. Under the current system, virtually all banking organizations (a bank with a holding company) are subject to two different federal regulators. Thus, the OCC and FDIC regulate national and non-member banks, respectively, while the FRB regulates the holding company of any such bank. Splitting the regulation of the overall organization in this manner is particularly hard to justify in the typical case where the bank holding company does not engage in any non-banking activities, or where the subsidiary bank holds virtually all the consolidated assets of the organization.

In addition to the concurrent jurisdiction of the bank and holding company regulator, there may also be overlap in the regulation of holding company subsidiaries. For example, the securities broker-dealer or futures commission merchant subsidiaries of bank holding companies are subject to concurrent regulation by both the Federal Reserve and the SEC or CFTC, respectively. Because there is no statutory priority as to which agency's regulations or policies should prevail in the event of conflict, there is a possibility of both wasteful duplication and open conflict between regulators.

4. Agency Responsiveness. For a variety of reasons, significant delays may occur in obtaining regulatory approval for otherwise permissible transactions or activities. For example, delays may be created because of confusion as to whether a given agency has jurisdiction, or in resolving opposing viewpoints of two or more agencies which possess concurrent jurisdiction. This problem has manifested itself in recent years regarding the appropriate definition of "bank" for purposes of the Bank Holding Company Act, with conflicting interpretations adopted by the OCC, FRB and FDIC.

Delays also occur when agencies decide to consider applying particular "policies" to transactions or situations not expressly subject to a statutory provision. For example, the FHLBB delayed various applications to acquire S&Ls by securities underwriters for a lengthy period while reviewing the implications of applying the policy of the Glass-Steagall Act (though not technically applicable) and prohibiting such transactions. Similarly, applications to the FRB by several holding companies to acquire state-chartered banks with insurance powers in South Dakota were withdrawn from consideration by the applicants at the suggestion of the FRB in order to give Congress time to consider legislation with respect to the issue.

In such situations the regulatory agency may be caught between the absence of express statutory restrictions against a particular transaction and a desire to maintain what the agency believes to be the "spirit" of existing legislation. However, where the federal statutory provisions are seriously outdated, it may be virtually impossible to determine Congressional "intent," since the market situation at issue may not even have been foreseeable by Congress. Lacking any new Congressional direction, the agencies in such a situation must fashion an appropriate action from agency "policy." However, where agency actions are guided by self-defined policy rather than express provisions of law, serious burdens can be created for private parties where they are unable to predict agency actions or where agency "policy" changes substantially (and often abruptly) following top agency personnel changes. The result can be sharply higher overhead costs that must be passed along to the consumer or absorbed, as well as slower development of new products or forms of service for the public.

Regulatory delays may represent a significant burden for institutions which seek to respond to competitive developments with new products or to take advantage of specific business opportunities through acquisitions.[17] In addition to raising the costs of individual transactions or deterring them entirely, general regulatory policies of an agency or express statutory requirements may also raise the cost of normal operations through unnecessary paperwork, contested hearings by competitors or in other ways. As well as penalizing the consumer through higher costs or fewer alternatives for services, the costs of delays and reporting requirements may also have a disproportionately severe impact on smaller institutions.

5. Difficulties in Management of Shared Responsibilities. The existing allocation of agency responsibilities frequently requires that several agencies cooperate when addressing certain financial institution issues. Problems of failing institutions, the supervision of bank holding companies and their subsidiaries, mergers and acquisitions, efforts to develop inter-agency uniformity in examinations and the deregulation of interest rate controls are all cases in point. At times problems of inter-agency coordination may unnecessarily delay favorable resolution of such issues, imposing needless costs on the institutions and their customers or undermining confidence in the financial system.

The current division of supervision for banks and their related holding company affiliates between two separate agencies may result in inadequate coordination in supervisory cases, as well as resulting in a certain degree of duplication in regulatory effort. As with divided supervision of a chain of banks under common ownership, the division of jurisdiction over a bank and its holding company could result in inadequate supervisory appreciation of the condition of the integrated organization, although in some cases the ability of a different agency to provide a "second opinion" on the status of a very large organization could also provide an extra element of useful supervisory review.

---

[17]For example, a full-service securities firm and a bank holding company might each be interested in acquiring a particular financial company, such as a mortgage banking or consumer finance company. Although under current law the bank holding company could not complete the acquisition without prior approval from the FRB (which could require three months or more to obtain), the securities firm would be free to complete the acquisition without any government approval. The securities firm would also be free to oppose the bank holding company's application for permission to acquire the company in question from the FRB. It is reasonable to expect that because of the uncertainties and delay inherent

(Footnote Continued)

6. Overlap and Conflict Between State and Federal Requirements. Because of the dual system for chartering and supervising depository institutions, some Federal controls over state-chartered entities may represent an unnecessary layer of regulation, and an area where greater deference could be given to state regulatory responsibilities. Unlike national banks, for example, in many cases state-chartered banks are subjected to examination by both state and federal regulatory agencies. Similarly, in most cases state-chartered depository institutions must obtain regulatory approval for branch locations, trust powers, acquisitions and other transactions from both state and federal agencies, while federally-chartered institutions must only obtain one such approval. Particularly with smaller depository institutions, the federal supervisory authorities could rely to a far greater degree than presently occurs on examinations by state agencies or even private accountants as occurs in several European nations. While specific federal laws applicable to state banks must be enforced, such enforcement could be delegated to capable state agencies as occurs with many federal health and safety, environmental, and other statutes.

D. Previous Reorganization Proposals

Since the late 1930s numerous proposals have been put forward by both governmental bodies and private groups for reorganization of the Federal agencies regulating commercial banks and other depository institutions. For example, in 1949 the Commission on Organization of the Executive Branch of Government (the Hoover Commission) suggested that: (1) the OCC more properly belonged under the FRB than in the Treasury Department; (2) the functions of the FDIC should be transferred to the FRB; and (3) all Federal bank supervision should be combined, preferably in the FRB. Similarly, in 1961 the Commission on Money and Credit recommended that the supervisory functions of the OCC and the FDIC be transferred to the FRB.

In 1975, the FINE Study of the House Banking Committee recommended the creation of a "super-agency" to combine all the supervisory and examination functions of the FDIC, FRB, OCC, FHLBB and NCUA. This proposal would have centralized jurisdiction over all state and federally-chartered depository institutions in a single, and much larger, federal agency.

Throughout the late 1970s, the Senate Banking Committee considered legislation introduced by Senator William Proxmire to remove all regulatory authority from the FRB and to transfer such authority to a new independent bank commission. Under Senator Proxmire's proposed legislation the OCC and FDIC would have been merged into this new agency, thereby creating a single consolidated agency to charter, regulate and insure all banks in the United States. While such an agency would wield

(Footnote Continued)
in its offer, the bank holding company would be forced to offer a higher price for the same company than the non-bank purchaser.

enormous power, under that proposal oversight authority for this super-agency would have been largely vested in the relevant Congressional committees rather than the elected government.

In contrast to the studies recommending consolidation of federal bank regulation, in 1971 the President's Commission on Financial Structure and Regulation (the "Hunt Commission") recommended that federal regulation of banks be divided among two separate agencies, based on whether a bank had a federal or state charter. More specifically, the Hunt Commission recommended that (1) an "Administrator of National Banks" should assume the supervisory duties of the OCC; (2) an "Administrator of State Banks" should assume the supervisory responsibilities of the FRB and the FDIC; and (3) a "Federal Deposit Guarantee Administration" should assume the insurance responsibilities (while maintaining separate insurance funds) of the FDIC, Federal Savings and Loan Insurance Corporation (FSLIC) and National Credit Union Share Insurance Fund (NCUSIF).[18]

The reorganization proposals enumerated above, although by no means exhaustive, suggest the scope and nature of the proposals for Federal regulatory reorganization to date. However, the repeated failure of proposals to consolidate the depository institution regulators suggests the extreme sensitivity of such plans for the many varied (and often diametrically opposed) interest groups. These include state and federal bank regulators; large and small banks, thrifts and credit unions; and depository and non-depository institutions.

This history of consolidation proposals suggests that attempts to achieve a single consolidated bank or depository institution regulator, irrespective of the specific details, may be so much at variance with our history and tradition in regulating financial institutions as to be not enactable by the Congress. This suggests that proposals to reorganize the responsibilities of the agencies along more coherent and comprehensive lines are more likely to serve as a practical starting point for modernization of the system than more ambitious plans for complete centralization. Finally, while previous proposals have generally centered on depository institutions, ongoing developments in the financial services markets suggest that many of the regulatory problems described above may now pertain to non-depository financial institutions as well.

---

[18] In 1981, legislation (S.1721) was proposed which would have consolidated the FDIC, FSLIC and the NCUSIF into one Federal deposit insurance fund as proposed by the Hunt Commission.

II. Goals and Objectives for Regulatory Change in the 80's

A. Goals of Financial Regulation

In recent years borrowers and lenders have been subject to both a higher degree of risk due to more volatile economic conditions and the rigidities of a financial regulatory system that was created in a different era for a different set of problems. In response to these new conditions, the market has introduced new financial instruments and new ways of doing business. Supporting this growth in new product and service offerings have been major developments in communications and computer technology that have not only reduced financial transaction costs but also enabled new financial instruments to compete efficiently in a variety of product markets and irrespective of geographic proximity.

The rapid pace of change in U.S. financial markets has raised fears of two kinds. On the one hand, a cumbersome regulatory system raises costs and may unnecessarily slow the rate of innovation. Lack of adequate flexibility in the regulatory system may both impair the competitiveness of particular types of firms and undermine overall safety and soundness by fostering inefficiency or predatory competition from less regulated firms. On the other hand, excessive division of regulatory responsibility to promote flexibility may create such a confused and diverse pattern of responsibilities that regulatory effectiveness may be impaired and inequities may proliferate.

In fact, the public's interest in a safe, sound and competitive financial system can be significantly impaired if the regulatory system is too greatly centralized to be flexible or too fragmented to be coherent or manageable. In this situation the regulatory system must balance often conflicting considerations to best serve the overall public interest. This in turn requires an appreciation of the broad goals that financial regulation should be designed to accomplish.

1. Stability of the Financial System

Without question, stability of the financial system is a paramount goal of financial regulation. The world's financial markets are tightly interconnected, and the sudden failure of one institution, especially one of significant size, could rapidly impair the viability of numerous unrelated institutions, both in this country and abroad. Without government systems to provide liquidity to financial institutions and to guarantee protection of deposits to certain levels, the failure of a single institution could spread into a more generalized crisis or collapse of public confidence in the overall financial system. Crises in financial markets and widespread bankruptcies of financial firms have historically been associated with serious recessions or even depressions, and financial disorder can also lead to inflation, destroying the value of the currency.

Because of these factors, demonstrated by the bitter experiences of the 1930s, the federal regulatory system was designed to assure the stability of the U.S. financial system under all circumstances. This commitment is especially manifest in the regulation of depository institutions, where federal deposit insurance and liquidity lending facilities represent a government support system unique among financial firms.

Nothing that has occurred in the last 50 years has reduced in the slightest the public interest in a stable and secure financial system. While some would debate whether more or less regulation is the best method of achieving a stable system, this debate should not obscure the fundamental public importance of a stable and secure system, or of the Federal government's absolute commitment to achieving this goal. If anything, the recent events involving the Continental Illinois National Bank, the nation's eighth largest bank, underscore both the continuing necessity of a safe and sound banking system, as well as the determination of the federal government to act when necessary to preserve the overall system against sudden destabilization.

Determining how best to achieve and maintain a safe and sound financial system, especially through improvements to the regulatory structure, is unquestionably the most important issue of public policy reviewed by the Task Group. However, while stability of the financial system is a paramount goal, regulatory programs should be designed to achieve stability of the system, rather than attempting to protect every individual private firm from failure. The goal is not a system in which financial firms never fail, as this could only be achieved through public subsidies, but rather one in which failures that do occur do not impair the stability of the financial system as a whole.

Probably no single area is as central to guaranteeing a stable financial system as the integrity and soundness of the U.S. banking system. Banks hold by far the largest portion of private financial assets, and they also have an important role in both the payments system and the transmission of monetary policy.

Both federal deposit insurance and the discount lending facilities of the Federal Reserve were designed to assure public confidence in the banking system and to protect depositors when bank failures occur. They also symbolize the extraordinary public support for the banking system and represent two key mechanisms for government intervention to maintain stability in the banking system.

While it is easy to articulate the overriding government policy of a safe and sound banking system, it is much more difficult to design a supervisory and regulatory system "best" able to achieve this goal. This is true because, among other things, the basic business of bank lending necessarily requires banks to assume significant risks.

In the course of their lending activities, banks take credit risks with a duration of years in many cases. Whether the borrower is an individual, a corporation or even a government entity, the bank must make a judgment whether future conditions will be such that the borrower will be able to repay the loan, and this judgment is subject to all the unforeseen events that may shape domestic or foreign economies. Regulatory controls such as lending limits, capital ratios and bad debt reserves are designed to insure that credit risks are diversified, and that the bank has adequate resources to absorb losses that may occur. Nevertheless, so long as banks lend funds to borrowers the banking business necessarily involves substantial risks that are generally greater than found in most other financial activities. Because of the degree of credit risk necessarily involved, for example, corporate lending by banks is inherently more risky than any type of strictly brokerage activity, whether involving real estate, insurance or securities, so long as the broker is not acting as a principal.[19]

In addition to credit risks, banks often must assume a degree of interest rate risk. This occurs because of the relatively short-term nature of their deposit liabilities and the relatively long-term nature of some of their loan assets.

Because banking is subject to significant competition from non-bank firms in most product areas, regulatory controls that are too stringent will impair the health of the banking system by weakening its competitive position and undermining its efficiency. These factors in turn would tend to result in higher earnings for non-bank competitors, with a gradual decline of condition for banks. On the other hand, regulation that is too lax may also lead to a weakening of the banking system, as some institutions will be tempted to seek out speculative gains while relying on government protection in the event of adverse results. The enormous size of some institutions also means that the failure of certain individual firms could impair the stability of the overall banking system, which the government must inevitably be prepared to support.

Because of these factors, assuring a safe and sound banking system necessarily requires a balancing of the need for effective regulatory oversight and the dangers of excessive regulation. In arriving at an appropriate balance it must also be kept in mind that regulations can jeopardize the safety and stability of the entire financial system where they artificially restrict competition or induce regulated firms to engage in activities that may be inefficient except for regulatory considerations. Indeed, by prohibiting diversification through activities that are often less risky than banking, and by confining banking to narrow geographic areas, regulatory controls can actually have an adverse effect on safety and soundness and the overall health of the banking system.

2. <u>Consumer Protection</u>

Consumer protection is another of the principal purposes and objectives of government financial regulation. Indeed, consumer protection is

---

[19] Many observers also argue that even underwriting of corporate equity securities is in many respects less risky than corporate lending, as the market exposure of an underwriter is generally less than a single day, and can in any event be hedged in financial futures markets. By contrast, bank loans once made are relatively illiquid and their credit risk cannot be hedged. While not necessarily involving greater risks than normal bank lending, securities and commodities activities certainly involve different types of risks that may require different types of expertise or leverage from those typically associated with banking.

especially important in less regulated markets because a significantly greater variety of products are likely to be available to consumers than is true under more rigid regulatory conditions. Without government standardization of financial products or interest rate ceilings, for example, full and accurate disclosure of the specific terms and prices of financial products and services becomes even more important than would be true in a more highly regulated market.

Maintaining financial stability is, of course, a prominent form of consumer protection. In addition, however, contract enforcement and fraud prevention are important and traditional objectives of government regulation. Disclosure requirements provide the information that consumers need to make sound financial decisions, and thereby reinforce the market mechanism. Deposit insurance is an important element of consumer financial protection, as well as helping to stabilize the financial system.

While consumer protection is an essential regulatory objective, truly protecting the consumer requires that each regulation be examined to make certain that its benefits exceed its direct and indirect costs. Consumers ultimately pay the costs of regulatory programs, including those intended solely to benefit consumers. Therefore, if a regulatory program costs more to operate than it saves, consumers will actually be disadvantaged rather than "protected." In fact, some programs which are ostensibly created for "consumer protection" may actually be no more than income redistribution or credit allocation plans, under which one group of consumers is required to subsidize another. Programs designed to steer credit to declining urban areas are an example of regulatory requirements designed to benefit residents of such areas rather than consumers as a group. While it may be socially desirable to provide assistance to such particular areas, use of indirect regulatory mechanisms (such as the protest provisions of the Community Reinvestment Act, for example) may be less efficient than direct tax or other incentives. Therefore, in addition to being cost-effective, consumer protection programs should be beneficial to all consumers on an equal basis, rather than designed to benefit particular interest groups.

3. <u>Promoting Efficient Delivery of Financial Services</u>

Financial instability in the 1930s was attributed by many to "excessive" competition, and this view supported a very substantial extension of regulatory controls over financial markets. More recently, however, many observers have reassessed the causes of the market collapse during the depression and have developed a renewed respect for the efficiency of competitive markets and a more sober appraisal of the costs of regulation.

Regulation tends to spread in unproductive directions as regulators seek to control isolated occurrences with rules of generalized applicability. While legitimate problems may require a regulatory response, regulations may impose unnecessary costs where they apply more broadly than necessary, especially where they restrain competition or fix prices. In addition, regulators are sometimes "captured" by regulated industries, and regulatory actions may sometimes be designed to protect the regulated firms more directly than the public at large. Ambiguous or outdated statutory language may also exacerbate these problems.

For these reasons, the promotion of efficiency by furthering fair and equal competition is a very important regulatory goal. Prevention of excessive concentration of economic power, through antitrust policy or otherwise, and freedom for financial firms to innovate are also very important to both the consumer and the competitiveness of the American economy in world markets. Absent competition, consumers pay higher prices and have fewer products from which to select. Inefficiencies in our systems of financial intermediation also mean that American firms pay higher prices for capital, thereby adversely affecting the competitiveness of American goods in world markets.

Competitive and efficient markets are also essential to the safety and soundness of the financial system over extended periods of time. Where unnecessary regulatory controls artificially restrict competition and create inefficiencies, the financial firms subject to such restraints are likely to become progressively less able to compete in an open market, and therefore more vulnerable to new competitors from other business sectors that are not subject to such restrictions.

While the promotion of competition and efficiency are essential elements of public policy regarding the banking system and other types of financial institutions, it must also be recognized that there are limits to the degree to which free market forces will be permitted to operate in the financial area. Indeed, the presence of explicit and implicit government support for depository institutions means that certain activities or the manner in which they are conducted may need to be limited to prevent risk taking that the market would not permit unsupported institutions to take or the creation of unfair competitive advantages against non-bank firms operating without a specialized government safety net.

B. Objectives for Specific Regulatory Reforms

Although the Task Group identified (i) safety and soundness, (ii) consumer protection, and (iii) vigorous competition as the paramount goals of financial regulation, the relative weight to be accorded each goal in its application to any particular issue is a question of judgment. Depending upon particular values, assumptions or experiences there can be many different proposals for reform, and there is no ascertainable "perfect" way to reorganize the financial regulatory system. Determining the most desirable of the potential regulatory alternatives ultimately requires balancing these three objectives in an attempt to maximize the degree to which they can actually be achieved.

The balancing of sometimes conflicting objectives in order to determine the most desirable regulatory system is inherently a judgment that each individual must make personally, based on his or her experience and philosophy. However, the recommendations of the Task Group nevertheless represent the collective judgment of its members as to the best balance and accommodation of the three principal goals that cannot be completely harmonized to negate all conflict between them. More specifically, the Task Group recommendations are predicated on one or more of several specific objectives, each of which is described below:

1. Regulation by function should be implemented where practicable, so that comparable activities at different types of financial institutions are regulated equivalently to the maximum possible degree.

2. Barriers to competition should be removed where not absolutely necessary to promote safety and soundness, as competitive markets are necessary to achieve the public's interest in an efficient financial system.

3. Unnecessary regulatory controls and regulations which are not cost-effective should be modified or repealed to reduce costs of financial services to consumers.

4. The organizational structure of regulation should be streamlined and responsibilities clarified without eliminating the checks and balances that generally characterize our system of government.

5. The dual system of chartering and regulating depository institutions by both the federal government and the several states should not be impaired.

1. <u>Regulation by Function</u>

Historically, federal regulation of different types of financial institutions has been organized so that a single agency exercised all the different types of regulatory controls applicable to a single type of firm. For example, securities, consumer, antitrust, civil rights and other regulatory provisions applicable to savings and loan associations are centralized today under the authority of the FHLBB, which also administers regulations relating to the safety and soundness of these institutions. To varying degrees a similar pattern of "institutional" regulation exists for other types of financial firms.

Institutional regulation offers the advantage of convenience for regulated firms by permitting "one-stop shopping" for regulatory matters. On the other hand, from a broader public policy standpoint institutional regulation has at least two major disadvantages. First, it involves duplication of effort among the various regulatory agencies. Thus, five separate federal agencies today regulate the securities activities of banks and thrifts, and five separate agencies handle antitrust review of mergers and acquisitions involving banks or thrifts.

Convenience for regulated firms may therefore be obtained to some extent only through greater duplication among government agencies. The second major disadvantage of institutional regulation is that it often results in differential regulation when different types of institutions compete across industry lines. During the era of sharp differentiation in the types of products offered by financial firms, institutional regulation operated largely without distorting the competitive balance among firms. If savings and loans, for example, offered a different product from banks or securities firms, then differences in regulation between S&Ls, banks and securities firms were relatively unimportant in their competitive consequences. So long as all S&Ls competing with each other to offer the particular type of financial product were regulated equivalently, fair competition could exist. Indeed, when the types of products offered were sharply delineated by type of firm, institutional regulation was also "functional" regulation to a high degree, since all firms offering a particular type of product tended to be subject to the same regulator.

As direct competition among different types of financial firms has increased, the problem of regulatory inequities has grown rapidly. As banks, securities firms, thrifts and insurance companies increasingly offer equivalent products and services to the consumer, their ability to be successful competitively may be affected by differences in the regulatory scheme applicable to them based on their historic type of business. Therefore, to an increasing degree the caprice of historic forms of regulation may interfere directly with the operation of a market driven system because consumer preferences are not expressed solely on the basis of the underlying investment merits. The application of interest rate controls to time deposits in depository institutions, while no such controls were applicable to money market funds, was a classic case of the regulatory system failing to regulate fungible products in an equivalent manner, thereby dictating the success of one type of product in the marketplace due to arbitrary differences in regulatory controls.[20]

By contrast to institutional regulation, "functional regulation" attempts to regulate each common activity or product by a single agency under a common set of rules, irrespective of the type of institution involved. For example, antitrust concerns regarding excessive concentrations of power apply equally to each of the different types of financial firms, as well as to non-financial firms from every economic sector. While under the current system each of the FRB, OCC, FDIC, FHLBB and DOJ review the competitive consequences of consolidations among depository institutions, greater consistency of antitrust enforcement would be achieved through administration of all antitrust laws by a single agency. Other activities such as the public issuance of securities may similarly benefit from a functional approach to regulation, where competing firms and products are treated equally under the law by a single agency, without regard for the type of firm which may be involved.

In short, functional regulation can serve the public interest by reducing duplication among different government agencies and by promoting equal regulation of competing activities by different types of financial firms. By making regulation "transparent" as to the type of firm

---

[20] The adverse competitive impact of Regulation Q on depository institutions has now been virtually eliminated. However, significant regulatory differences also exist in the regulations applied to different types of pooled investment media, such as bank common and collective trust funds, mutual funds and commodity pools, and in other areas.

involved, functional regulation helps promote the availability of the widest possible range of financial products for the public at the lowest possible cost, with different firms prospering or failing to the greatest degree possible on their efficiency and merits rather than because of arbitrary differences in government regulation.

While functional regulation promotes equality of regulatory treatment and reduces overall government duplication, it can also result in a particular type of firm (e.g. a savings and loan, credit union, etc.) having to deal with a variety of special-purpose agencies rather than a single agency. This can result in added regulatory costs for such types of firms because they must deal with more than one agency. Therefore, application of functional regulation in any particular case requires a balancing of the costs and benefits that would result, and a recognition that functional regulation may not be suitable in every area. As a result, the overall public interest will most likely be obtained through a mix of institutional and functional regulatory programs, rather than a system consisting exclusively of either type of regulation. Under such a system depository institutions and securities or commodities firms would continue to have most of their internal operations and safety and soundness concerns handled by a single agency, while activities common to many different types of firms or specialized issues would be handled by the appropriate functionally-oriented agency.

2. Removal of Unnecessary Barriers to Competition

As previously discussed, vigorous competition is essential to assuring the efficiency of the nation's capital markets. The relative efficiency of our capital markets in turn influences the cost of capital for American firms and consumers, and in this regard has a direct impact on the competitiveness of American goods and services in the world marketplace. Unnecessary barriers to competition inevitably raise prices, reduce alternatives and, ultimately, reduce jobs in the overall economy by preventing the aggregate output of goods and services from reaching its full potential. While many regulatory restraints may be necessary and desirable to prevent excessive concentration of power, to promote safety and soundness, provide disclosure of material business information or otherwise, such restrictions should always be designed to achieve their objectives with the smallest possible restraint on competition.

3. Reduction of Unnecessary Regulatory Costs

Whether through higher interest rates on automobile, mortgage or other loans, reduced rates of return on savings accounts or other investments, or higher charges for specific services, the user of financial services ultimately pays for the costs of complying with government regulatory controls. Where regulatory programs impose greater transaction or other compliance costs than the benefits they create, the public is ultimately disadvantaged. Therefore, it is never sufficient to inquire only whether a regulation has a desirable objective (e.g., consumer protection, safety and soundness, etc.). In addition, each specific regulatory control should be evaluated to make certain that the manner in which it is applied insures that public benefits outweigh public costs.

In general, the problem of unnecessary costs is often created when regulatory controls are imposed more broadly than necessary or are out-dated in relationship to current market practices. For example, the requirement that consumers have a 3-day "cooling off" period before creating a security interest in their home may have beneficial effects for a limited group of consumers, yet it may also unnecessarily penalize other consumers such as by delaying their ability to refinance a mortgage at a lower interest rate.

Similarly, state "merit" securities laws that prohibit the sale of securities if their terms are not expressly approved by state regulatory agencies have often resulted in unnecessary economic barriers to the capital formation process. Since these requirements vary from state to state, compliance can be difficult and time-consuming, and requirements are frequently not applied consistently among different states. These regulations may be effective in protecting some consumers from fraudulent offerings, which is certainly a desirable goal. However, other consumers, and perhaps the overall economy, are penalized because these regulatory controls also effectively bar, or significantly raise the cost of, many legitimate offerings. This is particularly a problem with offerings by small businesses and emerging companies in new high technology fields.

Finally, the opening of a branch of a bank or thrift may present a supervisory issue in the most rare of circumstances, but more than 99% of all applications to open branches are now approved. This strongly suggests that an automatic approval subject to veto in a particular supervisory case would accomplish the necessary regulatory purpose at a dramatically reduced level of regulatory burden. These cases illustrate the necessity for assessing both the goal for a particular regulatory program and also the means by which it is to be achieved. Inefficiencies can be avoided only where rules are tailored to apply as narrowly as possible to achieve the desired objective.

4. Maintaining Checks and Balances

In the business world, elimination of duplication in operations generally produces greater efficiency and reduced costs. However, excessive centralization can reduce efficiency and increase costs by creating too many layers of administrative personnel and inhibiting innovation. Because private firms are under constant competitive pressure, firms which do not maximize efficiency and good management will suffer adverse financial results.

As in the private sector, elimination of unnecessary overlap and duplication among government agencies can produce real savings for the public, and it should be a high priority of any government to eliminate waste and inefficiency. However, unlike the private sector, governmental organizations frequently do not face the same competitive pressures for efficiency and good management that are encountered by private firms. Consequently, there must be checks and balances among the branches of government in order to prevent excessive concentration of government power from developing.

Eliminating overlap and duplication in regulatory programs can produce real cost savings for the public by eliminating administrative overhead or duplicate programs. However, as government agencies become larger and more diverse operationally, more and more internal bureaucratic levels are inevitably created in the agency's chain of responsibility. This can result in slower decision-making, higher personnel costs and reduced public participation than might occur with a smaller agency.

As a result of these factors, centralization of responsibilities cannot be exclusively pursued without consideration of any possible offsetting costs and dangers through excessive concentration of government power over the financial system, and the inflexibility that may result from bureaucratic centralization. To a certain degree checks and balances in the regulatory system are important in maintaining, over time, a diversity of views regarding critical regulatory issues. Such checks and balances also help keep the overall system resistant to unanticipated problems and enable it to be more flexible in the face of changing markets.

While checks and balances are an essential element in regulatory organization, beyond a certain point the creation of checks and balances may result in a system that is too highly fragmented to be able to operate coherently. Therefore, achieving the optimum regulatory organization requires a balancing of the benefits of reducing overlap and improving consistency and the costs of bureaucratic centralization, which may include excessive rigidity and slowness to adapt to changing situations. Complete consolidation and chaotic fragmentation represent the opposite extremes in regulatory organization, and both involve significant potential costs to the public.

5. Dual Federal and State Financial Regulation

Since the earliest days following American independence, the states have been engaged in the chartering and regulation of banks. States subsequently began chartering and regulating both thrift institutions and credit unions. Except for limited periods, the federal government did not begin chartering banks until formation of the OCC as part of the Treasury Department under President Lincoln. Even after creation of a federal chartering authority, however, the states continued their own role in tandem with the new federal program.

Through the years, the existence of this "dual" federal and state system has provided a safety valve against out-dated or inflexible regulatory controls being imposed by either federal or state authorities. Acting as laboratories for change, the states have frequently developed new forms of financial services, which then spread nationally through federal action. For example, the states originated both checking accounts and branch banking. In recent years states began the chartering of credit unions and invented the NOW account as a device to permit the payment of interest to consumers on funds essentially equivalent to checking accounts. In both cases Congress subsequently implemented these programs on a national basis, although without the prior experience of the states to rely on Congress might never have acted, or at least not for several additional years.

Because it has served the financial needs of the nation so well over time, state participation in the chartering and regulation of financial institutions can genuinely be regarded as one of the finest examples of cooperative federalism in the nation's history. Because the balance of state and federal regulatory participation helps promote the public interest in a safe and competitive financial system, the dual system of chartering financial institutions should be maintained and strengthened wherever possible.

At the same time that the states are an important element in maintaining a dynamic financial system, it is useful to recognize the strong role that the federal government must also play. Financial markets may once have been insulated by geography, but they have long since become tightly inter-connected both throughout the United States and between this nation and the rest of the world. Local traditions and needs are very important, of course, and must be respected and served by a responsive financial system. Nevertheless, fostering safe and efficient national capital markets is a critical priority for federal financial regulation.

The nation's capital markets are interwoven to a degree that events in one area are likely to have a significant impact in many other states. The failure of Oklahoma's Penn Square National Bank, for example, had significant repercussions on institutions in many other states. Similarly, financial events in Europe, Asia or other areas can significantly impact major U.S. financial institutions in both their lending and deposit-taking activities, as recent events have graphically demonstrated. Obviously U.S. financial firms can also have a significant impact on financial markets across the world.

Maintaining efficient national capital markets, protecting U.S. financial markets from interruption due to foreign events and insuring that the international consequences of U.S. financial activities are consistent with this nation's responsibilities as a leading member of the world community all require an active or standby role for the United States Government. In particular, these responsibilities involve a significant role for both the Treasury Department and the FRB.

Therefore, from a public policy perspective the regulatory system must accommodate both national and local interests. Maintaining a strong dual role for the states as participants in the financial regulatory system is in this case both a local <u>and</u> a national interest.

III. Summary of Proposals for Reform

A. Elements for Reform of the Bank Regulatory System

The Task Group identified four fundamental principles, set forth in Figure 4, that any plan to reform the three federal agencies that

FIGURE 4

FOUR PRINCIPLES OF REGULATORY REORGANIZATION

1. The ''Dual Banking System'' and other elements of checks and balances in the system should be maintained.

2. There is no need for 2 different federal agencies (the FRB and FDIC) to handle day-to-day regulation of state-chartered banks.

3. Whatever agency regulates the lead bank of any banking organization should also regulate its related holding company to eliminate overlap and inefficiency.

4. The Federal Reserve, as the nation's central bank, should maintain a meaningful role in the regulatory system.

regulate commercial banks should include. These principles were developed by the Task Group staff after reviewing the agency reports and comments submitted by the public to the Task Group in light of the goals and objectives for regulatory reform discussed earlier. Taken together, they represent the basis for both the staff recommendations and the final recommendations of the Task Group with respect to commercial bank regulation.

1. Checks and Balances. There is agreement within the Administration, with no appreciable dissent elsewhere, that the dual banking system and other elements of checks and balances in the overall system must be maintained. Throughout American history, no single government authority has ever been entrusted with regulatory authority over all American banks. Such an unprecedented concentration of regulatory power in the hands, ultimately, of a single individual or board could have a variety of deleterious effects, including a significant erosion of the dual banking system and a possible increased risk of unanticipated supervisory problems affecting all banks. These factors suggest strongly that more than one federal bank regulator should continue to be maintained.

2. Federal Regulation of State-Chartered Banks. Since 1980, when state non-member banks were granted access to the FRB's discount window and were required to post reserves with the FRB, the differences, from a regulatory perspective, between state-chartered member and non-member banks have been largely eliminated. However, each type of state-chartered bank remains subject to a different federal agency. While some slight differences remain based on voluntary membership in the Federal Reserve System, the uniform applicability of reserve requirements, availability of discount window and payment facilities and applicability of federal banking laws to both member and non-member banks has eliminated the necessity or desirability of maintaining two different federal agencies to regulate state-chartered banks. Therefore, the number of general purpose federal regulatory agencies can and should be reduced from three to two, with either the FDIC or FRB assuming all federal oversight responsibilities for state-chartered banks. Consolidation of the regulatory programs of the FRB and FDIC would significantly reduce the number of duplicative federal bank regulatory agencies without creating any of the new risks that could be associated with total agency consolidation.

3. Unified Regulation of Banks and Their Holding Companies. The rapid expansion of the use of bank holding companies (See Figure 3), often to permit geographic expansion of activities, achieve tax benefits or for other reasons that may not be germane to supervisory concerns, has underscored the desirability of making it generally possible for a bank and its holding company to be regulated by the same agency, irrespective of which agency that might be. This is in contrast to the current system in which, in most cases, there is one regulatory agency for the bank and another agency for the parent holding company. Indeed, the number of registered bank holding companies regulated by the FRB is more than 100 times larger than when the statute was enacted, and over 40 times larger than when the last major amendments affecting the statute's scope were passed in 1970. This suggests that Congress may not have fully realized the number of banks that would eventually become subject to the special

overlay of holding company regulation by an agency other than their primary bank supervisor.

A bank and its holding company are not totally independent entities, but rather constitute an integrated and interdependent business organization. There is only one set of shareholders, and there is often only one team of senior management personnel. To be sure there can be important legal and practical differences between the operations of a bank and that of its holding company. These would include the importance of conducting non-banking activities in separate holding company subsidiaries rather than in the bank itself to prevent unfair financing advantages for non-banking activities and to permit equal regulation of specific activities such as securities or commodities brokerage. The fact remains, however, that the bank and its holding company comprise a single organization whose overall financial condition can be influenced by the success or failure of any of its various constituent parts.

Despite the apparent simplicity of a single agency to regulate all holding companies, a major drawback of this approach is that in almost all cases different agencies will regulate separate parts of these banking organizations. Thus, the current system is, in practice, more complicated than one under which each integrated banking organization was regulated by a single regulatory agency, irrespective of the technical form of its corporate organization. In fact, today state member banks and their holding companies do have the FRB as a single federal regulator for both bank and holding company, while both national and state non-member banks are subject to two different federal supervisors.

The failure to regulate bank holding companies together with their constituent bank(s) may create the largest duplication in the current system from the point of view of regulated entities. Indeed, thrifts, credit unions, securities and commodities firms all respond to a single regulator irrespective of the presence of a holding company. By contrast, many individual transactions involving banking organizations are subject to review by two different federal bank agencies, and the regulated firm must therefore deal with two different sets of agency personnel, regulations, operating procedures and the like rather than only one.

The division of authority between regulators of banks and holding companies also creates a risk that, if close contact is not maintained by the agencies, supervisory problems may not be sufficiently well understood or handled because no single agency is responsible for regulation of the entire consolidated organization. Unification of the regulation of each individual bank and its holding company in a single agency would eliminate this problem, thereby significantly improving the supervisory process <u>and</u> reducing regulatory costs for regulated firms by eliminating a layer of duplicative review for many transactions.

Therefore, even if other agencies may regulate different banking organizations based on charter or other differences, there is a strong advantage to be gained in having, to the greatest practicable degree, each separate banking organization subject only to a single federal regulator with authority over all its activities, whether undertaken in the bank itself or in an affiliate. Such a system would simplify the federal regulatory system by having one agency rather than two to review and approve various transactions. It could also improve supervision by avoiding the need for inter-agency coordination between the FRB and the FDIC or OCC in order to develop a comprehensive picture of the financial and managerial situation of each overall organization.

While the current system of multiple regulators for a bank and its holding company increases costs and, in some cases, the difficulty of coordinating federal regulation of a single organization, it may also be beneficial in some cases by creating a "second opinion" on regulation of a particular firm. Particularly when a very large and complex institution is involved, a second federal regulator may serve as a useful check and balance against the possibility that a single agency might fail to detect or deal with a major supervisory problem soon enough. Therefore, the benefits of a unified regulator for a bank and its holding company must be weighed against the possible costs, in a few cases, of eliminating the participation of a second agency. Since many very large state member banks and their holding companies have long been regulated solely by the FRB at the federal level, however, such a "unified" regulatory system would not appear to present any significant supervisory concerns, and would probably materially strengthen supervision in a great majority of cases.

4. Regulatory Role of the FRB. Finally, there is a consensus that the FRB should maintain a sufficient level of supervisory and regulatory authority to back up its responsibilities as the central bank.

Some persons and groups argue that the FRB should not be involved in supervision and regulation of banks or their holding companies, but rather that it should limit its efforts strictly to the formulation and implementation of monetary policy. However, having the central bank in such a weak position might undercut the long-term stability of the financial system.

Financial crises can erupt quickly, with little or no advance warning. Problems emanating from domestic or foreign events could cause sudden difficulties for financial firms that, if left unchecked, could spread to other financial firms in a chain reaction. In such an event there would almost certainly not be sufficient time for Congress to act to forestall significantly adverse economic consequences.

Because of these factors, some agency must have authority to act as a "crisis manager," with the ability to stabilize the situation and thereby to give time to Congress and the President to fashion and implement a longer-run response where necessary. As the immediate source of liquidity for U.S. banks that may experience temporary liquidity problems, the FRB has long performed this role under our system. Indeed, its responsibilities for providing standby liquidity facilities are often referred to as being the "lender of last resort."[21]

Operation of the FRB's discount window is a vital element in the public "safety net" supporting stability of the banking system. Particularly in the event of difficulties affecting a large financial institution, the FRB must remain available to provide potentially extremely large amounts of liquidity on extremely short notice, and it is the only government agency that is in a position to provide this type of support to the financial system.

The FRB also has important responsibilities with respect to the functioning of international financial markets. The foreign activities of U.S. banks and the domestic activities of foreign banks both necessarily involve communication and coordination between the respective national supervisory authorities and central banks.

To be effective in carrying out its responsibilities, especially relating to sudden threats to the overall financial system, the FRB must have certain institutional capabilities. Among these are accurate and timely information concerning financial and economic conditions, as well as the capacity to evaluate the necessity of a government response to particular situations to maintain financial stability. Assuring that the FRB maintains these capabilities suggests strongly that it should have a role in a broader spectrum of financial issues than merely those directly encompassing "monetary policy."

While there are strong reasons for the FRB to maintain a participation in the regulatory system, this does not mean that all its current responsibilities are necessary. Indeed, as the previous discussion has indicated, the FRB's existing responsibilities with respect to the regulation and supervision of bank holding companies are broader than necessary. Therefore, with respect to the regulatory authority of the FRB the important public policy question is not whether the FRB should have a regulatory presence, but rather what magnitude or degree that presence needs to assume in order to assure a strong central bank, while minimizing unnecessary regulatory burdens on the private sector.

---

[21]This description is not entirely accurate, as the ultimate potential lender of last resort to the financial system is the Treasury Department, representing the financial resources of the United States. However, Treasury has no "official" role except for specific extraordinary situations under Congressional authorization. By contrast, the FRB continuously provides liquidity to financial institutions both in the aggregate (through open market operations) and in specific cases (through discount window lending).

B. Summary of Recommendations to Reform the Bank Regulatory System

At present, the OCC, FRB and FDIC all exercise authority over their respective types of banks, while two different agencies regulate banking organizations where a national or state non-member bank is owned by a holding company. Antitrust authority is concurrently exercised by the three bank agencies and the Justice Department, while securities activities of banks are regulated by the OCC, FRB or FDIC, but by the SEC for bank holding companies. The different types of regulatory functions performed by each agency at present and as revised by the Task Group proposals are shown on Figures 5 and 6.

Regulation of Banks. Under the Task Group's plan the number of agencies involved in ordinary day-to-day bank supervision would be reduced from the current three to only two. Although each of the current agencies would continue to exist,[22] the pattern of authority would be greatly simplified. Under the Task Group's proposals, the new Federal Banking Agency ("FBA") would continue the OCC's current responsibilities for supervising all national banks. However, unlike the current system in which the FRB and FDIC both regulate state-chartered banks, under the Task Group's recommendations all federal regulation of state chartered institutions would be centralized in the FRB, except for regulation pertaining expressly to deposit insurance.

At the same time that federal regulation of state chartered banks would be consolidated in the FRB, other proposals of the Task Group would establish a new program under which highly qualified state agencies would assume much of the current federal supervisory role for state-chartered banks, with residual monitoring and standby authority vested in the FRB. The "certification" program, which is discussed below, would permit state agencies to assume exclusive responsibilities for examining and supervising many state-chartered institutions now subject to dual state and federal examinations. This program would permit federal efforts to be targeted on states where additional assistance may be most beneficial or institutions which involve special supervisory considerations.

Regulation of Bank Holding Companies. At the same time that federal bank regulation would be consolidated in the FBA for national banks and the FRB for state-chartered banks, both the FBA and the FRB would have the authority to examine and supervise the parent holding companies of the banks that they otherwise regulate.[23] To the extent "certified",

---

[22] The OCC would, however, be renamed in recognition of its increased responsibilities.

[23] In the case of multi-bank holding companies which include subsidiary banks with both national and state charters, holding company authority would be based on the "lead" or largest subsidiary bank in the particular holding company. The "minority" subsidiary banks in any multibank holding company would continue to be subject to their relevant supervisory agency based on charter type. However, the regulator of the lead bank in any such organization would have authority as regulator of

(Footnote Continued)

FIGURE 5

FUNCTIONAL ANALYSIS OF
EXISTING FEDERAL BANK REGULATION

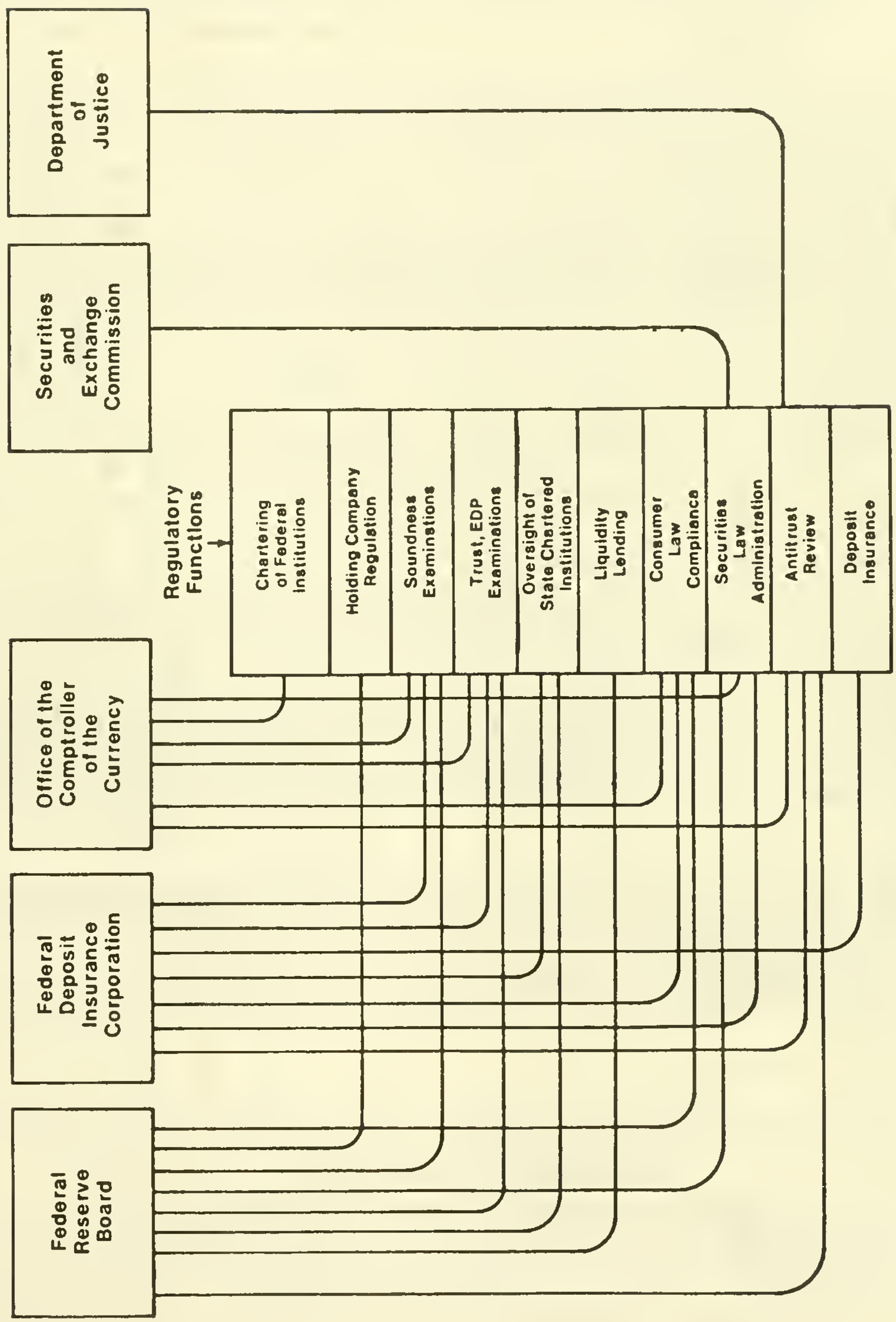
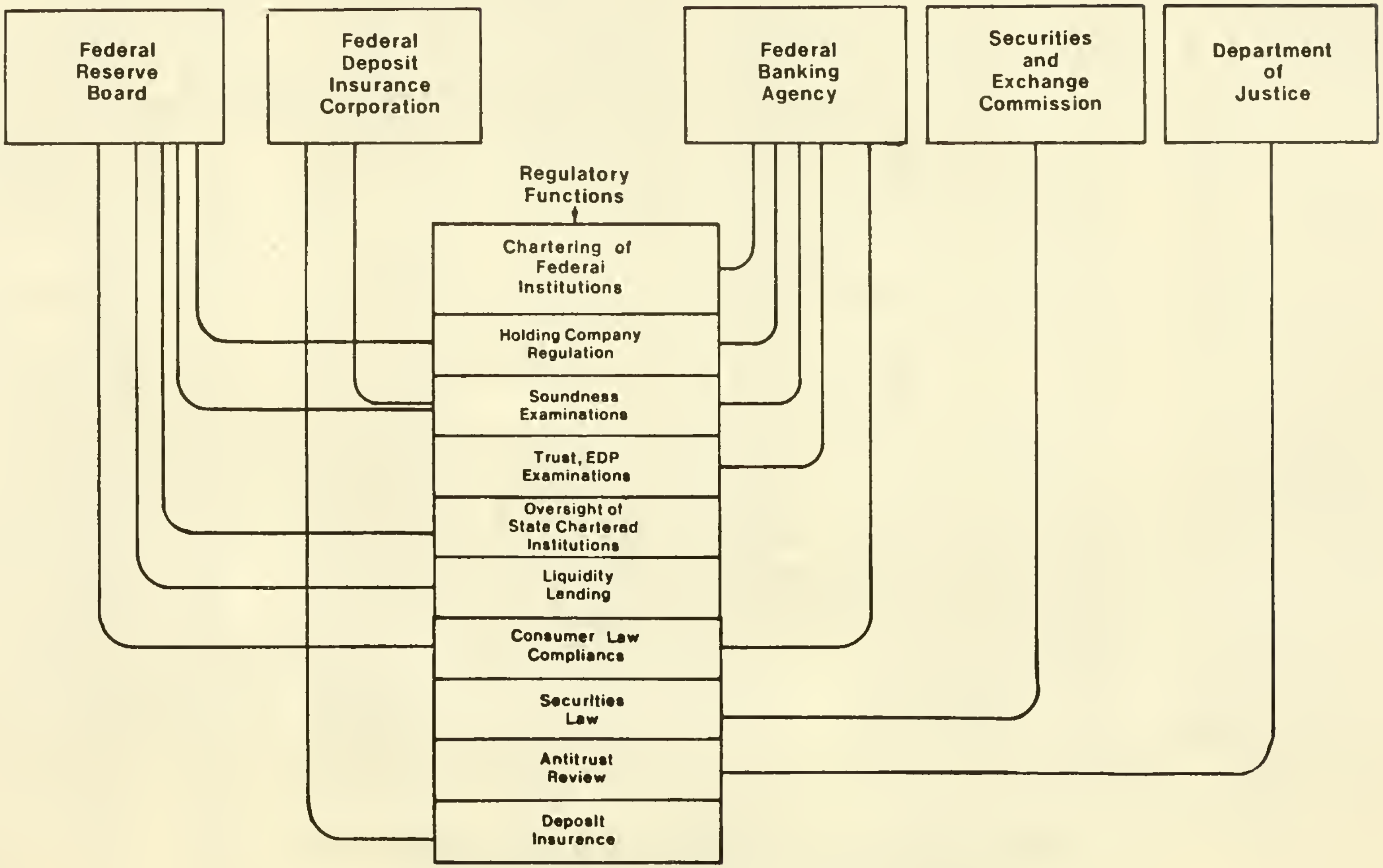


FIGURE 6

FUNCTIONAL ANALYSIS OF PROPOSED FEDERAL BANK REGULATION



state agencies would examine and supervise the holding companies of banks which they regulate. Rather than having multiple federal regulators for a bank and its holding company, the Task Group recommendations would establish a "unified" system under which a single federal agency would be responsible for all the related operations of any individual banking organization. Figures 7 and 8 show the changes proposed by the Task Group in the federal supervisory system for banks and their holding companies.

As a result of this change, every banking organization would be able to have a single federal regulator, except for the "international class" holding companies described below and those multi-bank holding companies that choose to have both state and national bank subsidiaries. Where a bank had a national charter, the bank and its holding company would be regulated entirely by the FBA, instead of the OCC <u>and</u> the FRB under the current system. Similarly, a state non-member bank with a holding company would be examined and supervised entirely by its state regulatory agency, or the state agency and the FRB (depending on the extent to which a particular state was "certified"), instead of the FDIC, FRB and the state agency today. State member banks would retain the FRB as their federal supervisor for both bank and holding company as occurs today, subject to the certification program. Figures 9 and 10 demonstrate the simplification in regulatory structure that would result from this unification of bank and holding company regulation.

Because two different federal agencies[24] would have responsibilities for the enforcement of the Bank Holding Company Act, additional provisions would require the FRB and FBA to establish common requirements for holding companies under their supervision in various specific areas. In this connection, prudential standards (such as capital requirements) for bank holding companies could not be changed without the mutual concurrence of both the FRB and FBA. Similarly, the two agencies would mutually consult regarding policy issues or interpretations arising under the BHCA, and they would be required to harmonize reporting requirements to the greatest practicable degree.

As proposed by the Task Group, "international class" holding companies would be defined as those domestic institutions which engage in a domestic banking business in one or more foreign countries or whose size is sufficiently large that supervisory problems affecting any such institution could have a national or even an international impact.[25]

---

[24]As well as state agencies to the extent "certified" under the new program recommended by the Task Group and described herein.

[25]This is defined under the Task Group proposal to mean any institution with more than ½ of 1% of aggregate holding company assets, or approximately $12.5 billion at the present time. This threshold for "international class" status based on size would escalate upward to the extent that the aggregate assets of holding companies increase from current levels.

FIGURE 7

EXISTING FEDERAL REGULATION OF COMMERCIAL BANKS AND THEIR HOLDING COMPANIES

(EXCLUDES PURELY INSURANCE FUNCTIONS OF THE FDIC)

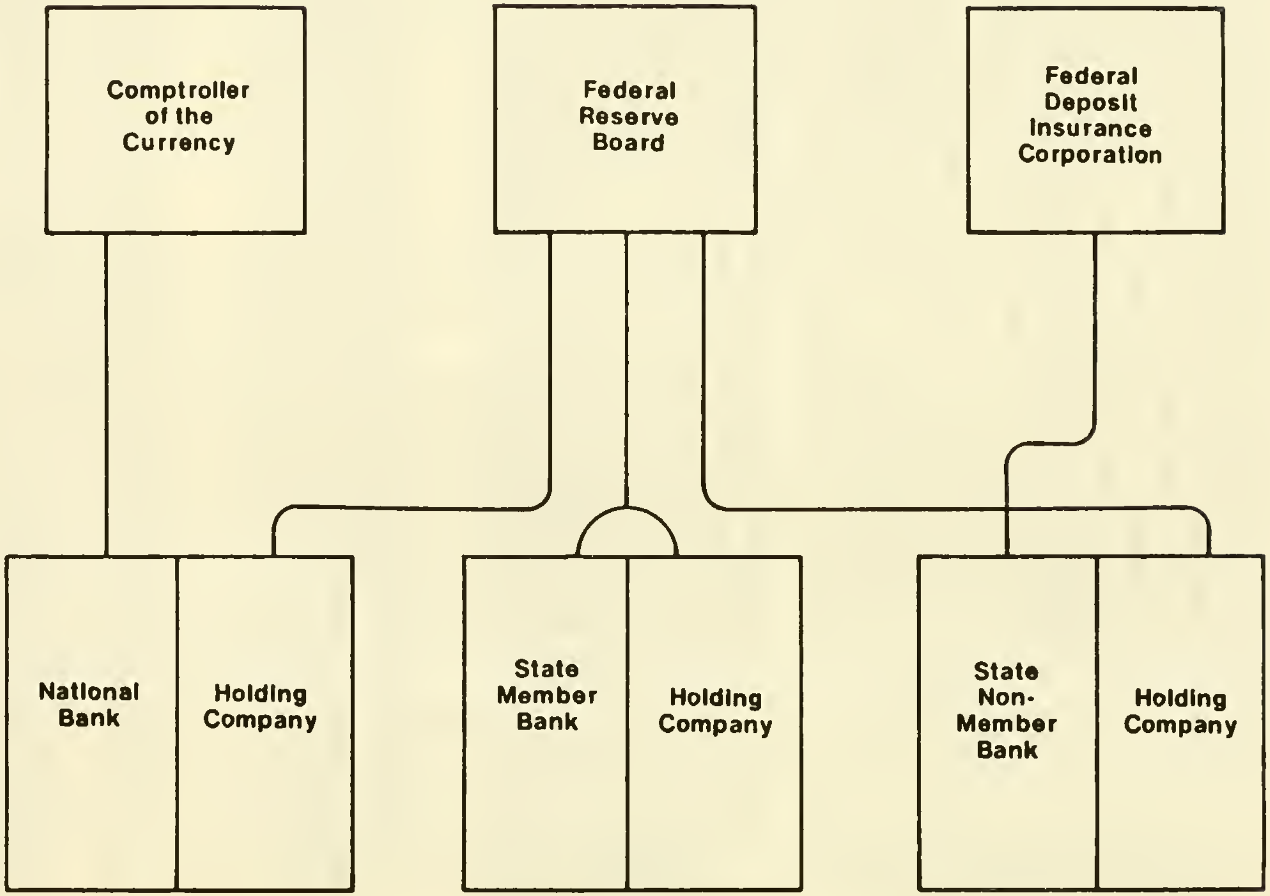
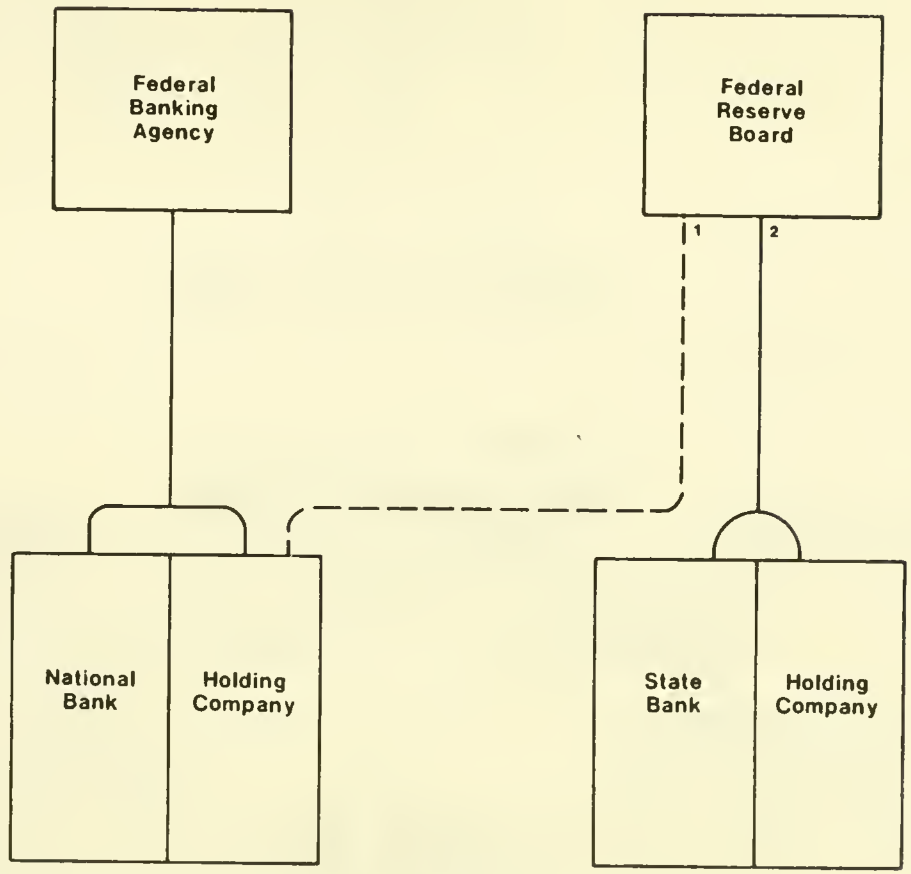


FIGURE 8

PROPOSED FEDERAL REGULATION OF COMMERCIAL BANKS AND THEIR HOLDING COMPANIES

(Excludes Purely Insurance Functions of the FDIC)



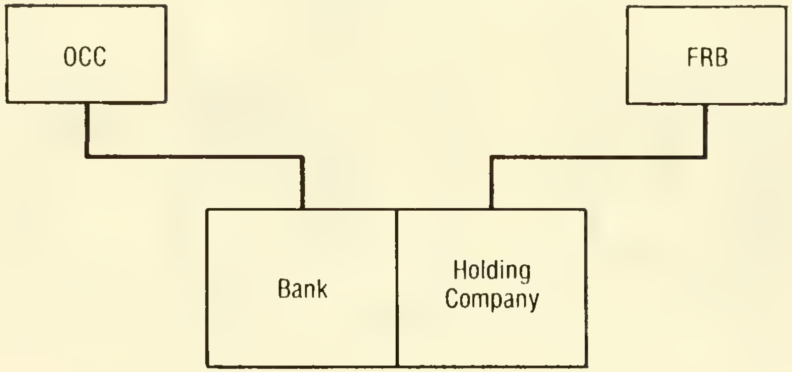
1. Only for those holding companies of national banks (35) which qualify as an "international class" holding company.

2. To the extent responsibilities are not transferred to the states.

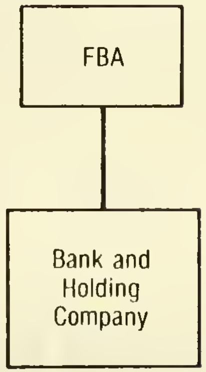
FIGURE 9

Regulation of National Bank and Holding Company

Under Status Quo



Under Task Group Recommendations*

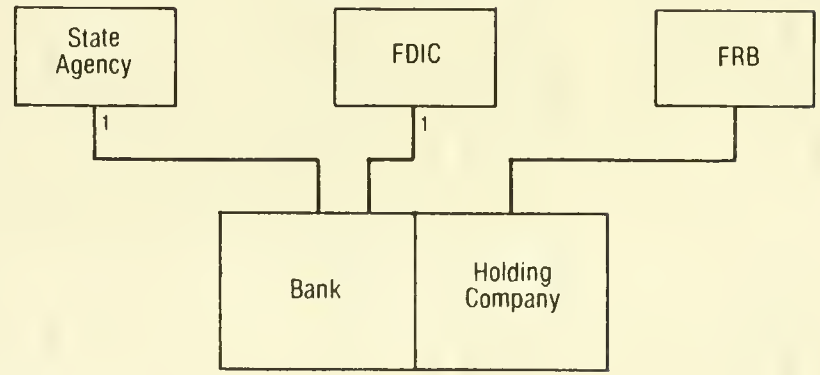


* Except for ''international class'' holding companies, where status quo would remain unchanged

FIGURE 10

Regulation of State-Chartered Non-Member Bank and Holding Company

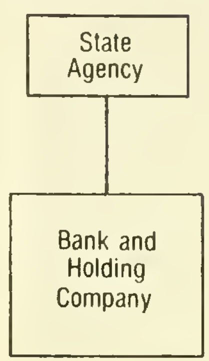
Under Status Quo



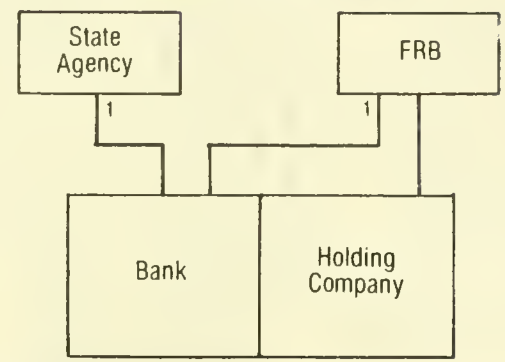
[1]Alternate year programs in effect in many states.

Under Task Group Recommendations

If State Fully Certified



If State Not Fully Certified



[1]Alternate year programs to remain in effect as at present.

Recent events demonstrate that difficulties involving any of the nation's largest banks will have unique implications for the overall financial system. Because extraordinary government measures may have to be taken to guarantee the integrity of the U.S. banking system in the event of difficulties threatening any of our largest banking organizations, there is an inherent justification for special regulatory oversight of such institutions. This does not mean that our largest banks should be unfairly penalized through more restrictive limitations on their substantive activities, but rather that the size, complexity and systemic role of these institutions is sufficient to warrant special supervisory and regulatory mechanisms.

Under the Task Group proposals approximately 25 of the largest U.S. bank holding companies and 25 other domestic bank holding companies with significant foreign banking activities would fall under the proposed definition of "international class" institution at the current time. These 50 domestic institutions would remain subject as they are today to Federal Reserve supervision of their holding companies, although regulation of the subsidiary banks of such firms would not be affected and would continue to be based on charter type. The FRB would also maintain jurisdiction over foreign bank holding companies operating in the U.S.

Under the Task Group recommendations, responsibility for interpreting the limitations on non-banking activities contained in the Bank Holding Company Act and for promulgating the list of such permissible activities (including implementing regulations) for all bank holding companies (including "international class") would be transferred from the FRB to the FBA. This change in the responsibility for establishing the permissible non-banking activities for bank holding companies would reflect the appropriate role which should be played by the elected government in a democratic society in making determinations which so directly affect the competitive health of the banking industry.

While the FRB would give up its current authority over the powers of bank holding companies, which it has exercised exclusively for almost 30 years, the FRB would retain a right to veto the list of permitted activities or the implementing regulations (together with certain individual orders). Such a veto could only be exercised within a 30-day period following action by the FBA, and only where 2/3rds of the Board of Governors of the FRB made a written finding that any proposed new power or implementing regulation would undermine the stability of the U.S. banking system or have a seriously adverse effect on safe and sound financial practices.

This allocation of responsibilities between the FBA and FRB would permit the executive branch to take the lead in formulating policy affecting bank holding companies, from which it is today generally excluded, while at the same time preserving a strong role for the FRB in developments which may affect the safety and soundness of the U.S. banking system. Obviously through legislation Congress could also reverse or otherwise limit any decisions of the FBA concerning the powers of bank holding companies.

Operation of Deposit Insurance System. Under the Task Group's recommendations, the FDIC would give up all examination, supervision and regulatory responsibilities not directly related to its function of providing deposit insurance. The FDIC would remain an independent corporation, but would be refocused exclusively on providing deposit insurance and administering the deposit insurance system. As part of this change in orientation, the FDIC would transfer its current responsibilities for day to day supervision, examination and regulation of state non-member banks to the FRB, or state supervisory authorities where certified.

At the same time, the FDIC would target its own efforts on troubled institutions that may pose a direct risk for the deposit insurance system. In this regard, the FDIC would have authority to deny insurance, set premium levels related to risk and revoke insurance. It would also have the authority to take enforcement action against violations of federal law regarding unsafe banking practices in any bank examined by it where the primary regulator failed to take such action upon prior request of the FDIC.

Under the revised system, the FDIC would examine all troubled banks (irrespective of charter type) in conjunction with the primary supervisor, together with a sample of non-troubled firms. Except in extraordinary cases the FDIC would examine troubled banks jointly with the primary supervisor,[26] while the sample of non-troubled firms would be examined in cooperation with the primary supervisor on a pre-determined basis.

Under the revised system the FDIC would have an ability it does not now possess to act as a true watchdog for the insurance system. It would have both the responsibility and the ability to monitor (together with the primary supervisor) all troubled institutions that represent the greatest risk to the insurance fund. In addition, by becoming involved with problem situations at an earlier date, the FDIC would be better able to prepare for possible extraordinary situations such as by developing contingency plans involving larger institutions.

Illustrating the simplification recommended by the Task Group, Figures 11 and 12 show two common transactions as they are reviewed under the current system and as proposed by the Task Group, respectively. Formation of a new national bank and a holding company (or acquisition of a newly-formed bank by an existing holding company[27]) would require 2 steps under the Task Group's proposals rather than 4 under the status quo. An even more dramatic reduction would occur in the levels of review

---

[26]The primary supervisor and FDIC should be free to agree on alternating examinations where they may feel it appropriate.

[27]In states where branching continues to be formally prohibited, but multibank holding companies are allowed, such a transaction is necessary in order to open the equivalent of a new branch office.

Formation of National Bank and Holding Company

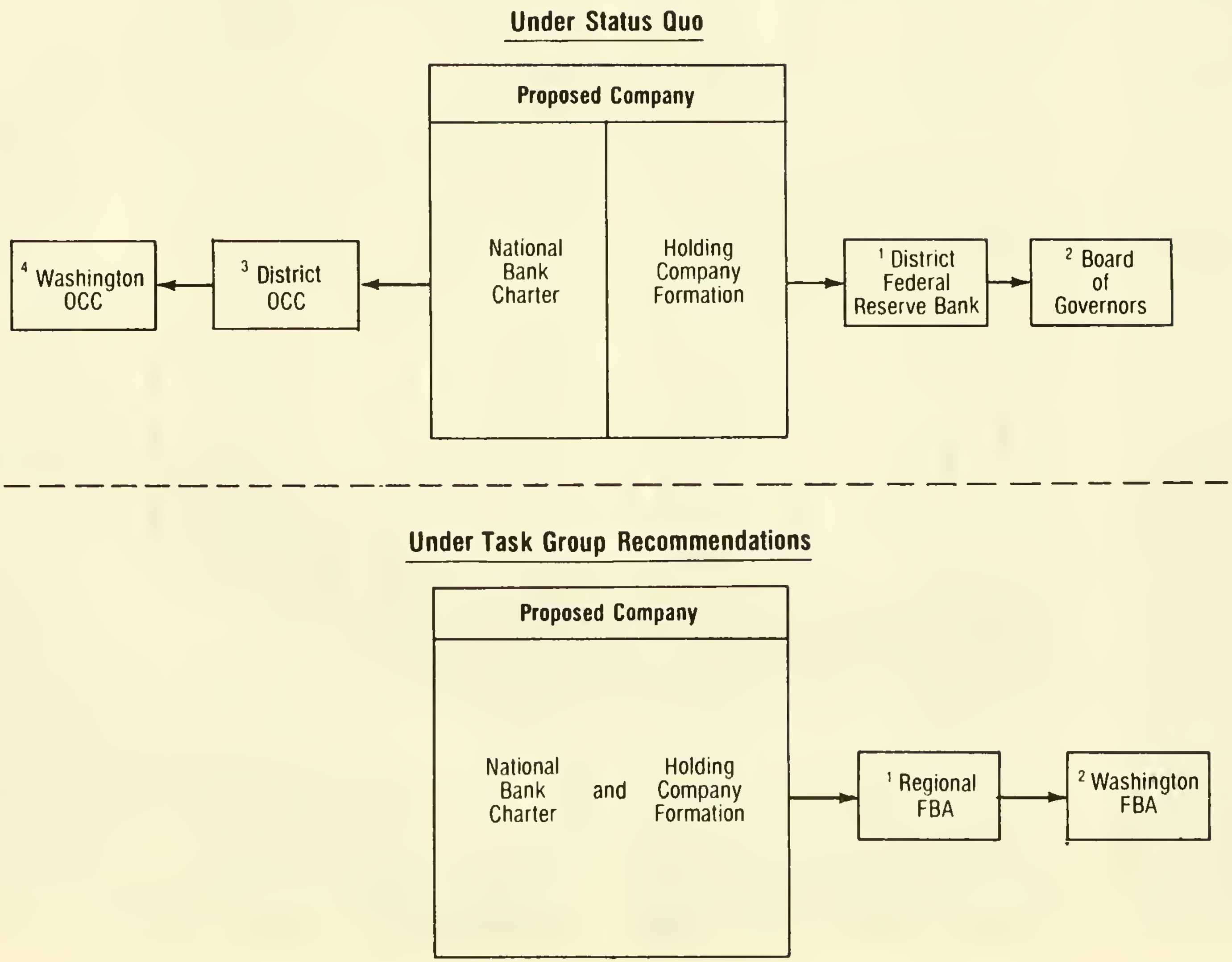
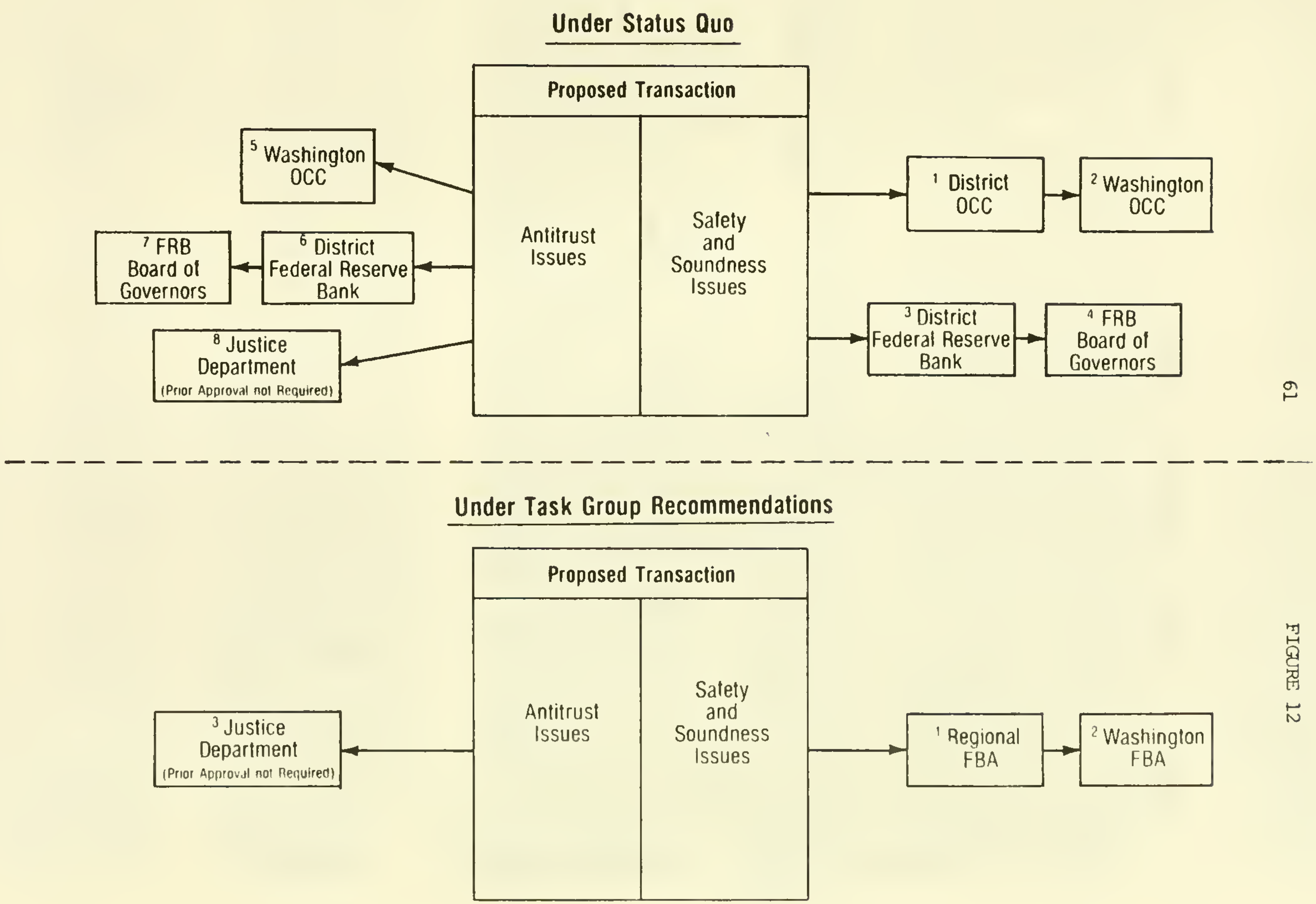


FIGURE 11

FIGURE 12

Regulatory Review of Proposed Merger of Two National Banks and Their Holding Companies



for a merger between two national banks and their holding companies. Under the Task Group proposals such a transaction would be reviewed at 3 levels, compared with the 8 separate steps in the federal approval process under the status quo.

C. Summary of Recommendations to Reform the Thrift Regulatory System

Under the current system, eligibility for regulation by the FHLBB as a thrift institution is determined solely by charter type, despite the fact that in recent years the powers of thrift institutions to engage in a wide variety of financial activities similar to banks have been significantly expanded. As proposed by the Task Group, the FHLBB would continue to regulate thrift institutions, but only to the extent such institutions continued to compete to a significant degree in traditional thrift activities. Individual thrifts would be free to abandon specialization in traditional activities, but in such event the institution would be required to convert to regulation as a bank in recognition of the activities such institution elected to pursue. In addition, the FHLBB would transfer its current examination and supervision of state-chartered firms to state agencies where "certified" under a program similar to that proposed for banks by the Task Group.

The policy of functionally-determined regulation for thrift institutions would be implemented by creating a "portfolio asset test" to measure the percentage of an institution's assets invested in housing and housing-related financial instruments. Thrifts that did not satisfy the portfolio test over an averaging period would be required to obtain a bank charter and FDIC insurance. These institutions would become subject to all statutes and regulations applicable to banks, including the Bank Holding Company Act. Thrifts that failed to satisfy the portfolio test would also lose eligibility for advances under the Federal Home Loan Bank System.

At the same time that thrifts that became _de facto_ banks would be regulated as banks under the Task Group's proposals, banks with the same minimum degree of specialization in traditional thrift activities would have the option of converting to thrift status. In short, under the Task Group's proposals thrift regulation would be based on what an institution does in the marketplace, rather than what type of charter it may have originally received or what it calls itself.

As part of this new system, the FSLIC would be required to indemnify the FDIC for losses resulting from the failure of a converting thrift institution during the 4-year period following its conversion to FDIC insurance. Similarly, the FDIC would be required to indemnify the FSLIC upon the failure of banks that converted to thrift status within the same time period.

D. Summary of General Regulatory Proposals

In addition to the organizational reforms proposed for the bank and thrift regulatory systems, the Task Group also recommended a variety of other proposals designed to improve the operation of the deposit insurance system, create significant new opportunities for a greater state regulatory role, reduce unnecessarily burdensome restrictions under various specific securities and banking statutes and to centralize all enforcement responsibilities for depository institutions under the securities and antitrust laws in the SEC and DOJ respectively.

Reform of Deposit Insurance. Under the Task Group recommendations, the FDIC and FSLIC would be authorized, but not required, to institute systems of risk-related insurance premiums. Under such a system, for example, institutions with less capital, higher proportions of classified loans, earnings difficulties or other factors making them greater risks for the deposit insurance system could be required to pay a higher premium for their deposit insurance coverage. While not replacing traditional supervision, risk-related deposit insurance premiums would help to strengthen the stability of the overall system by reducing the subsidy that is inherent in the current system for the riskiest institutions.

Similarly, the Task Group recommended that the FDIC and FSLIC should be required to adopt common minimum capital levels and common accounting standards for insurance purposes. These capital and accounting standards would be jointly determined by the two insurance agencies and then phased in over a suitably long period, such as 7 years. A relatively long transition period is required to enable thrift institutions to rebuild their seriously reduced capital levels in an orderly fashion.

In a deregulated environment, depository institutions of all types may encounter greater variability in earnings compared with their experiences under a system of government protections and controls, such as government-mandated interest rate ceilings. While capital alone is not a substitute for good management and strong earnings, its role as a buffer against adverse earnings has increased importance under a system of unregulated interest rates.

The relative capital level (also referred to as the degree of "leverage" of a firm) has a direct impact on its pricing structure and competitive abilities. A firm with a 50-1 debt to equity ratio (2% capital) can achieve a given rate of return on its equity with far lower overall earnings, for example, than can a financially stronger firm with only a 20-1 debt/equity ratio (5% capital). Therefore, a competitive advantage can be derived from having less capital, and therefore less of a buffer against loss.

With respect to normal types of firms, market discipline prevents a firm from maintaining an excessive degree of leverage in its capital structure. This discipline is exerted through reduced credit ratings and reduced access to credit, along with higher financing costs. However, the existence of federal insurance for banks and thrifts turns excessive leverage from a problem into a competitive advantage. Due to the FDIC and FSLIC, depositors and other creditors may be willing to deal with even severely under-capitalized firms. Because good public policy demands that government programs encourage depository institutions to be financially strong and stable, rather than to be chronically weak, the

Task Group recommended that the FDIC and FSLIC should be required by law to adopt common minimum capital standards and accounting rules by which capital is determined. This step is necessary to prevent different types of firms from engaging in a "competition in leverage" due to different requirements for obtaining government insurance backing, and thereby undermining the overall stability of the financial system.

Federal-State Duplication. Under the Task Group recommendations, federal duplication of state regulatory oversight of state-chartered banks and thrifts would be reduced to the maximum extent consistent with safety and soundness considerations. To this end some existing federal controls over matters that do not relate to an insured state-chartered institution's solvency would be repealed. Furthermore, where state examination programs were deemed by federal authorities to be equivalently reliable to those of the federal government, the federal agencies would largely rely on state examination and supervision of particular sizes or types of state-chartered institutions or their holding companies, subject to appropriate residual authority of the FRB and FDIC in the case of banks or the FHLBB (and FSLIC) in the case of thrift institutions.

Under the proposed "certification" program, existing federal examination and supervision would be transferred to the states that have or develop strong and reliable regulatory programs. While no change from the status quo would result for states that are not certified, this program would create new incentives for states to develop stronger supervisory and examination programs by eliminating redundant federal oversight to the extent states were "certified." This program will also create an incentive for states to develop improvements over existing federal examination and supervisory procedures, such as through better off-site data monitoring, greater reliance on private auditing firms or otherwise.

Functional Regulation and Streamlining. Under the current system, the OCC, FDIC, FRB and FHLBB are each responsible for enforcing the securities and antitrust laws as they may apply to banks or thrifts regulated by such agencies. However, the SEC administers the securities laws for bank and thrift holding companies, and the Justice Department independently reviews all bank and thrift transactions under the antitrust laws. The result is that 5 different federal agencies regulate securities and 5 different federal agencies have a role in antitrust issues, when in each case only 1 agency could handle such responsibilities. The Task Group recommendations would centralize these responsibilities in the SEC and DOJ, respectively.

The Task Group also recommended changes in various banking and securities laws where significant regulatory costs are imposed on the public without an adequate offsetting benefit. For example, a statute designed to combat organized crime through both criminal and civil penalties against racketeering (the Racketeer Influenced and Corrupt Organization Act, or "RICO") has increasingly been utilized by imaginative lawyers in suits against banks, securities firms, accountants and other perfectly legitimate businesses without even any alleged connection to organized crime.

RICO is attractive to litigants because it provides triple damages and attorneys fees that are unavailable under banking or securities laws, as well as due to the breadth and ambiguity of the statute. The result has been rapidly growing litigation involving an organized crime statute that was never intended to apply to legitimate activities of financial institutions. This litigation increases the backlog in federal courts, undermines the structure of the substantive banking and securities laws enacted by Congress and creates totally unnecessary costs for the affected firms and, ultimately, their customers. Consequently, the Task Group recommendations would limit the application of the civil penalty provisions of RICO to prevent their misuse by private parties in cases solely involving legitimate business activities by financial institutions.

In other areas the Task Group recommendations would eliminate or narrow the application of various regulatory controls to reduce unnecessarily burdensome regulatory controls while maintaining all essential public protections. For example, applications for federal approval of the location of branches and automatic teller machines that are otherwise lawful under state law are without any discernible public benefit. The Task Group would eliminate all federal advance approval requirements, while permitting the regulatory agencies to limit branching by a particular institution for specific supervisory reasons.[28] This recommendation would eliminate thousands of completely unnecessary applications that are unrelated to safety and soundness, as well as reducing unnecessary costs for the installation of electronic facilities to serve consumers.

Other Task Group recommendations would reduce the extensive and costly litigation experienced by investment companies regarding advisory fees, permit the adoption of common plans of distribution for "families" of mutual funds without advance approval by the SEC and eliminate or streamline other provisions of securities law.

The Task Group recommendations are discussed in detail in Part II of this Report. While the number of federal agencies would be maintained, in its aggregate the Task Group recommendations would substantially reduce confusion and duplication, clarify the agencies with primary responsibility for particular functions and reduce the overall regulatory burden on regulated institutions and their customers. While supervision would be significantly improved, the checks and balances which form such an important part of the current federal regulatory system would be preserved. The result of these changes would be a regulatory system better able to serve the public interest in the decades to come.

---

[28]State authority to determine the intra and inter-state branching authority of banks under the McFadden Act and the Douglas Amendment to the Bank Holding Company Act were not addressed by the Task Group and would not be affected by this recommendation.

PART II
RECOMMENDATIONS OF THE TASK GROUP ON REGULATION OF FINANCIAL SERVICES

I. ELIGIBILITY FOR THRIFT REGULATORY TREATMENT

1.1 - Retention of the Federal Home Loan Bank System

The Federal Home Loan Bank Board should be retained and expanded to regulate all traditional thrifts, as well as banks with an equivalent thrift portfolio that desire thrift regulatory treatment. The FHLBB should continue to operate the Federal Home Loan Banks and the FSLIC.

1.2 - Functional Eligibility for Thrift Regulation

A portfolio test (the "Portfolio Test") should be established to determine whether an institution is in fact essentially engaged in traditional specialized thrift activities. Any institution that satisfies the Portfolio Test should be eligible to be regulated by the FHLBB as a thrift institution (a thrift institution that satisfies the Portfolio Test will be referred to herein as a "True Thrift"). True Thrifts would be regulated by the FHLBB, insured by the FSLIC and subject to all statutes and regulations applicable to thrifts and their holding companies. Conversely, any institution that fails to satisfy the Portfolio Test should be required to be regulated as a bank (a thrift institution which does not satisfy the Portfolio Test will be referred to herein as a "Thrift-Bank") and to obtain deposit insurance from the FDIC. After an appropriate transition period any such Thrift-Bank should be required to comply with all statutes and regulations applicable to banks and their holding companies.

1.3 - Characteristics of Thrift Status

While Congress should establish the specific Portfolio Test, the Task Group recommends that any such test should measure the participation of a thrift institution in financing residential housing (including housing-related investments such as mortgage-backed securities). In keeping with this recommendation, the Task Group recommends that eligibility for thrift regulation should be based on an institution electing to be specialized to the requisite degree in residential housing finance, rather than an alternative formulation involving the absence of commercial loans as a test.

The Task Group also recommends that in establishing a specific Portfolio Test, Congress should give special consideration to the situation of mutual savings banks, which have historically had a different portfolio composition than savings and loan institutions. The Task Group recommends that the Portfolio Test as applicable to savings banks should either require the same level of housing activities, phased-in over an appropriately long period of time, or else establish a permanently lower required percentage of housing finance assets.

1.4 - Eligibility for Banks to Elect Thrift Status

Any commercial bank should be entitled, but not required, to convert to a federal thrift charter with regulation by the FHLBB, if it (i) satisfies the thrift Portfolio Test, (ii) is in compliance with all rules and regulations of the FHLBB and FSLIC applicable to True Thrifts, and

(iii) is not under any formal administrative action by its existing supervisory agency (and has not been notified of the initiation of any such action). Any such bank that elected to convert to thrift status should be required to obtain deposit insurance from the FSLIC, which would be required to grant such insurance if the three factors described above were satisfied. Any such bank electing regulation by the FHLBB would be governed by all statutes and regulations applicable to thrifts and their holding companies.

1.5 - Small Thrift Exemption from Portfolio Test

The smallest thrift institutions (e.g., below $15 million assets) should be exempt from the Portfolio Test in order to reduce paperwork burdens and artificial results due to the extremely small size of the overall portfolio. All thrifts below this level would be eligible to remain subject to FHLBB regulation irrespective of portfolio composition.

1.6 - FDIC Insurance for Converting Thrift-Banks; Indemnification Arrangements

The FDIC should be required to grant insurance coverage to any FSLIC insured institution that, upon failure to satisfy the Portfolio Test, is required to convert from thrift to bank regulation and to obtain FDIC deposit insurance. However, after an appropriate transition period any such institution should be required to conform to all FDIC rules and regulations. In the event any such institution fails within a specified period (e.g. 4 years) from the date it acquired FDIC insurance, the FSLIC should be required to indemnify the FDIC for all its expenses in connection with the failure. The FSLIC should have the option to handle any supervisory matters during the indemnity period, as well as to participate in the examination of any converted institution during this period.

The same system should be applied when FSLIC insurance is required by a bank that elects to convert to supervision by the FHLBB, with similar indemnification arrangements.

Discussion of Recommendations

In recent years the asset powers of thrift institutions have been broadened as a result of both federal (principally the Garn-St Germain Act) and state legislation. Although some states permit an even wider spectrum of activities, at the federal level thrift institutions may now engage in most of the activities that are lawful for commercial banks, although thrift institutions remain subject to many restrictions (such as percentage limits on particular categories of such activities) that are not applicable to banks. The new powers of thrift institutions were designed to give thrift institutions greater flexibility in their investments, and thereby to provide additional sources of income in order to facilitate continuation of their traditional role in financing residential housing.

While there is an increased similarity in the legal powers of banks and thrifts, there is still a substantial distinction in practice between the typical activities of banks and thrifts. This is at least partly true because many thrift institutions have not yet had the time or resources to develop the new areas of business now open to them. However, under current law there is no minimum requirement for participation in housing finance or other traditional activities in order to remain eligible for federal regulation as a thrift institution. Consequently, a thrift institution can lawfully develop a portfolio of activities that is exactly identical to that of a bank, but still remain eligible for favorable thrift regulatory programs (such as long-term advances through the Federal Home Loan Bank system) designed to support traditional thrift activities.

From the standpoint of public policy, there is no justification for subsidizing or treating more favorably than banks those thrifts that have, in effect, become commercial banks. This would dilute the support intended to promote housing activities, as well as constituting a serious inequity for commercial banks not eligible for comparable regulatory treatment. Therefore, one of two possible options must be pursued. One alternative is to remove all remaining restrictions on the asset powers of thrift institutions and at the same time to eliminate the FHLBB and the Federal Home Loan Bank system. All thrifts would then become banks and be regulated as such.

This option of "homogenizing" bank and thrift regulation would maximize the product freedom of thrift institutions, while eliminating any regulatory disparities between banks and thrifts. However, while this approach would eliminate the favorable regulation of thrifts which have become de facto banks through their activities, it would also be an overbroad solution as to those thrifts that voluntarily desire to remain specialized institutions, largely to promote the financing of residential housing.

The Task Group recommends that a second alternative be adopted. Under this proposal, a separate regulatory system should continue to remain available for thrift institutions, but eligibility for thrift regulation should be contingent on maintenance of a minimum level of traditional thrift activities over an appropriate averaging period. Simply stated, only those thrifts that actually remain specialized in their competitive activities would continue to be eligible for specialized federal regulatory treatment under the FHLBB. Similarly, commercial banks that maintain the same level of commitment to housing finance would have the option of converting to regulation as a federal thrift institution.

By basing regulatory treatment on the current activities of individual firms, this proposal would preserve the diversity of our current system. At the same time, the Task Group recommendations would make the current system more equitable among competing firms.

Under the Task Group recommendations, eligibility for thrift regulation would be based on a portfolio test measuring the percentage of an institution's assets that are devoted to housing and housing-related financial instruments. This "Portfolio Test" would utilize an appropriate averaging period, and an institution that did not satisfy the test would not be eligible for regulation as a thrift institution at the federal level. For example:

a. A federally-chartered thrift that failed the Portfolio Test would be required to obtain a bank charter and FDIC insurance, and would become subject to all federal statutes and regulations applicable to banks. Unless it converted to a state bank charter, such an institution would be regulated by the proposed Federal Banking Agency.

b. A state-chartered thrift insured by the FSLIC that failed the Portfolio Test would be required to obtain FDIC insurance and would become subject to all statutes and regulations applicable to federally-insured state-chartered banks. Unless it converted to a national bank charter, such an institution would be regulated at the federal level by the Federal Reserve, subject to the state certification program.

c. A state-chartered, state-insured thrift institution that failed the Portfolio Test would not be eligible for membership in the Federal Home Loan Bank system, but would otherwise be unaffected by the Task Group proposals.

d. A commercial bank (state or federally-chartered) that satisfied the Portfolio Test would be eligible, but not required, to convert to a federal thrift charter with regulation by the FHLBB and insurance from the FSLIC. Upon conversion such an institution would become subject to all federal statutes and regulations applicable to thrift institutions, and it would be eligible to become a member of the Federal Home Loan Bank system.

Because the development of a specific Portfolio Test will involve many detailed technical considerations that Congress must ultimately decide as to the types and definition of specific qualifying assets, the Task Group did not recommend a specific Portfolio Test. The Task Group did unanimously conclude, however, that the Portfolio Test should measure an institution's percentage of specialization in residential housing and housing-related financial instruments. However, the Task Group also believed that, in formulating a specific test, Congress should (i) give special consideration to the situation of mutual savings banks and (ii) exempt the very smallest thrift institutions from the Portfolio Test to avoid any additional costs or paperwork burdens for such firms.

II. REORGANIZATION OF THE REGULATORY RESPONSIBILITIES FOR COMMERCIAL BANKING ORGANIZATIONS

A. Reorganization of Bank Regulation

2.1 - Creation of the FBA

a. A new agency, called the Federal Banking Agency, should be established as an Executive Branch banking agency by incorporating into the existing Office of the Comptroller of the Currency the responsibilities of the FBA as outlined below. At the same time, the title of the Comptroller would be changed to the "Director of the Federal Banking Agency."

b. The Director of the FBA should be appointed by the President and should report to the Secretary of the Treasury on broad policy issues and on overall budget and staffing matters. However, the FBA should have exclusive authority over corporate applications, such as charters, the safety and soundness considerations of mergers of institutions, and all supervisory and examination matters relating to individual institutions.

c. The Secretary's approval authority regarding overall policy, budget and staffing matters should reflect existing statutory oversight responsibilities and should focus on maintaining conformity with Administration programs such as economizing in these areas. However, the FBA's budget should be funded from assessments rather than appropriations, and FBA employees should be exempt from OPM regulations concerning staffing and compensation. Current OMB authority over personnel levels should continue to apply to the FBA.

2.2 - Regulation of National Banks

The FBA should regulate, supervise and examine all national banks, together with their holding companies as described in Part II.B. However, the current authority of the Federal Reserve Board over national banks by virtue of their membership in the Federal Reserve System should remain unchanged.

2.3 - Regulation of State-Chartered Banks

To the extent a state is not certified as provided in Part IV, the FRB should be responsible for federal regulation, supervision and examination of state-chartered banks, together with their holding companies as described in Part II.B. As with national banks, current FRB authority over state member banks would remain unchanged, and the FRB could establish special procedures for member banks in certified states.

2.4 - Regulation of Foreign Banking Organizations and Activities

The FBA and FRB should continue to exercise their respective existing authority (that of the OCC in the case of the FBA) over foreign bank branches, agencies and subsidiaries operating in the U.S., and U.S. banking organizations overseas. The current authority of the FDIC over the overseas activities of state non-member banks would be transferred to the FRB.

Discussion of Recommendations

Since the creation of the OCC under the Administration of President Lincoln in 1863, the Treasury Department has played an integral role in the regulation of the nation's banking system. This role is both direct, through the supervisory jurisdiction of the OCC over national banks, and indirect through the wide range of its domestic and international financial responsibilities, many of which have an unavoidable impact on financial institutions.

Among other things the Treasury necessarily plays a leading role in issues of domestic and international taxation, as well as being primarily responsible for developing and implementing the Executive Branch's domestic and international financial policies. In addition, the Treasury is the ultimate source of financial support for the financial system in any time of extreme crisis, and any such event affecting the entire national economy or banking system, whether emanating from foreign or domestic sources, would necessarily involve the Treasury Department in its resolution.

As a result of these institutional concerns, the Treasury Department has played, and should continue to play, a role in the regulation of the nation's banking system. This insures that Treasury will maintain a significant level of "real-world" understanding of the banking system so that it will be prepared to act wisely in any financial crisis situations. Finally, as the principal financial agency of the elected government, it is appropriate for the Treasury Department to play a leading role in the development of government policy affecting the commercial viability of the banking system.

While the Task Group concluded that the Treasury Department should maintain its institutional role in broad policy issues affecting bank regulation, it also determined that matters involving individual institutions, such as charter applications, merger approvals and enforcement actions not involving broad national policy questions should continue to be handled as under the current system on an autonomous basis by the FBA.

While the basic institutional structure for regulation of national banks would remain unchanged under the Task Group proposals, the current agency should be renamed the "Federal Banking Agency" to better connote the agency's increased stature and its new responsibilities under the Task Group proposals. In fact, as proposed by the Task Group the FBA would become the Federal government's lead agency for establishing overall policy with respect to the competitive powers of bank holding companies under applicable legislation.

In order to insure that the new FBA would be able to attract and retain a consistently high quality staff and to fund all necessary activities without interruption, the Task Group also recommended that the FBA should be funded through assessments on regulated firms, rather than through congressional appropriations. As proposed, the FBA would also be free to determine staff compensation levels without reference to salary limitations or schedules otherwise applicable to government employees, as is already the case for the personnel of various other regulatory agencies. However, the FBA should be subject to review of its overall personnel levels by both the Treasury Department and OMB.

With respect to federal regulation of state-chartered banks, the Task Group determined that a significant portion of existing federal examination and supervision should be transferred to capable state agencies. Even where the state agencies are not sufficiently strong to handle supervision exclusively, however, the Task Group decided that two different federal agencies were not necessary to supervise state-chartered banks. While the number of non-member banks is significantly greater than that of state member banks, the aggregate asset share of the two types of banks is almost equal. Consequently, either the FDIC or FRB could logically assume all federal regulation of state-chartered banks.

The Task Group unanimously recommended that the FRB should assume the current responsibilities of the FDIC for examining and supervising state non-member banks. However, many of these non-member banks are expected ultimately to be examined and supervised solely by state authorities pursuant to the new certification program. The certification program would also extend to state member banks, although the FRB would be authorized to adopt special procedures applicable to state member banks in recognition of the voluntary nature of membership for state chartered banks. Consolidation of all federal responsibilities for oversight of state-chartered banks in the FRB would reduce the number of federal supervisory agencies from 3 to 2, as well as permit the FDIC to concentrate its full resources on its preeminent responsibilities for operating the deposit insurance system.

B. Regulation of Bank Holding Companies

2.5 - Powers of Bank Holding Companies

The Federal Banking Agency should assume the current responsibility of the FRB for promulgating the list of permissible activities under the Bank Holding Company Act, together with the regulations implementing such list of activities, for all bank holding companies (subject to the requirements and procedures described herein).

2.6 - Disapproval of Holding Company Regulations by the FRB

Pursuant to Recommendation 2.5, the current responsibilities of the FRB for writing the list of permissible activities and regulations implementing such list of activities for all bank holding companies under the BHCA should be transferred to the FBA. However, in performing these functions the FBA should be required to work with the FRB as follows:

a. The FBA should furnish the FRB with a copy of any proposed regulation[29] as soon as practicable, but in no event later than 30 days

[29]The term "regulation" as used in Recommendation 2.6 means regulations (or portions thereof) to establish or change (i) the list of permissible activities or (ii) the implementation of such list of permissible activities.

prior to publication for public comments. FRB comments on such proposed regulations could be furnished at any time, either prior to publication or during the public comment period. Adverse FRB comments should not prevent FBA publication of proposed regulations, but at the request of the FRB the FBA should publish any comments of the FRB along with its proposed regulation.

b. The FBA should furnish the FRB with a copy of proposed final regulations[30] at least 30 days prior to publication in the Federal Register. Prior to publication the FRB could disapprove such regulations (or portions thereof) if the Board of Governors (the "Board"), by a 2/3 vote, (i) made a formal determination that the adoption of such list or regulations would be reasonably likely to impair the stability of the U.S. banking system or have a seriously adverse effect on safe and sound financial practices, and (ii) transmitted a written report to the FBA reporting the basis for the Board's determination.

c. In the event a proposed regulation or order for an individual applicant is disapproved by the Board under the procedures as set forth herein, such regulation or order should not become final or effective. However, the determination of the Board to disapprove as provided herein should be subject to judicial review in proceedings brought by private parties, although the FBA should not participate in any such suit brought against the Board by a private party.

2.7 - Supervision of Holding Companies

In general, each individual banking organization (a bank and its parent holding company) should be subject to a single federal agency, rather than dividing responsibilities between one regulator for the bank and a different agency for the holding company. An exception to this general principle should be made, however, for "international class" holding companies as defined below. To accomplish this objective, the supervision of bank holding companies should be revised as follows:

a. The FBA should regulate, supervise and examine all holding companies of national banks, based on the charter status of the lead bank[31] and subject to the other provisions hereof.

b. Where states are not certified to perform such responsibilities, the FRB should regulate, supervise and examine holding companies of state banks, subject to the list of permissible activities and regulations implementing such list of permissible activities promulgated by the FBA and the other provisions hereof.

---

[30]Since proposed orders of the FBA approving nonbanking activities not yet permitted by general regulations for an individual applicant are identical in effect to changes in the list of permissible activities, they would also be subject to the disapproval procedures of this paragraph.

[31]As used herein, the term "lead bank" means the largest single bank (in asset terms) in a multibank holding company, and regulation of holding (Footnote Continued)

c. To the extent states are certified to perform such responsibilities, state banking authorities should supervise and examine holding companies of state banks, subject to the regulations of the FBA as described above, residual regulatory authority of the FRB and the other provisions hereof.

d. The FRB should continue to regulate, supervise and examine all "international class" holding companies, subject to the FBA list of permissible activities and regulations implementing such list of activities. This FRB jurisdiction should include both review of holding company applications and establishment of prudential standards for any such holding company, but regulation of the subsidiary bank(s) of any such holding company should remain unchanged.

e. An "international class" holding company would be defined as a bank holding company that: (i) owns or controls U.S. banks with foreign branches[32] or material foreign banking subsidiaries, (ii) has assets which total more than .5% (one-half of one percent) of aggregate bank holding company assets, or (iii) is a foreign bank or foreign holding company which owns or controls a U.S. bank or owns or controls a foreign bank with U.S. branches, agencies or banking subsidiaries.

2.8 - Coordination of Holding Company Regulation

Because under the new system regulation, examination and supervision of bank holding companies will be divided between the FBA, FRB and, to the extent certified, state authorities, mechanisms will be necessary to coordinate policies, regulations, reporting requirements and interpretations of the BHCA. Such consultation and cooperation should be provided as follows:

a. The FBA[33] should be authorized to review and comment on applications or notices filed with the FRB by holding companies of state-chartered banks or by international class holding companies, as well as concerning general policy matters relating to holding companies under consideration by the FRB. Where the FBA submitted to the FRB adverse comments on a particular application or notification (including any related interpretation of the BHCA) the FRB should be required to consider such comments and should provide the FBA with a written report as to the basis for its decision where it determines to proceed notwithstanding FBA comments.

(Footnote Continued)
companies by the FRB and the states should similarly be determined on the basis of the charter status of the lead bank in each holding company.

[32] "Branches" mean full-service banking facilities engaged in a domestic deposit-taking business in a foreign country, and does not include limited purpose or "shell" offices.

[33] And state authorities to the extent certified.

b. The FRB should be authorized to review and comment on applications or notices filed with the FBA by holding companies of national banks subject to its regulation, as well as on general policy matters relating to holding companies under consideration by the FBA. Where the FRB submitted to the FBA adverse comments on a particular application or notification (including any related interpretation of the BHCA), the FBA should be required to consider such comments and should provide the FRB with a written report as to the basis for its decision where it determines to proceed notwithstanding FRB comments.

c. The FBA and FRB should make any changes to existing prudential standards (e.g. capital levels, etc.) by mutual agreement. Neither the FRB nor the FBA should be authorized to change existing prudential standards without the concurrence of the other agency in order to insure that prudential standards for holding companies remain consistent.

d. The FBA and FRB should develop reporting requirements for holding companies regulated by them in mutual consultation, and in a manner consistent with the streamlined reporting that would be implemented by the Administration's proposed Financial Institutions Deregulation Act ("FIDA"). The agencies should establish common reporting requirements to the maximum possible degree, but identical forms would not be required by law.

e. State agencies certified to regulate, supervise or examine holding companies of state-chartered banks should be subject to the list of permissible activities and regulations implementing such list of permissible activities promulgated by the FBA, as well as the joint prudential standards established by the FRB and FBA.

2.9 - Streamlined Reporting Requirements for Bank Holding Companies[34]

Reporting requirements under the BHCA should be streamlined. Bank holding companies' nonbank subsidiaries engaged in the securities business should satisfy the BHCA reporting requirements by submitting to their holding company regulator the same information submitted at the same time to the Securities and Exchange Commission ("SEC") under Section 17 of the Securities Exchange Act of 1934 (the "Exchange Act"). All other nonbank subsidiaries should satisfy the BHCA reporting requirements by submitting to their holding company regulator the same information submitted to the SEC under Section 13 of the Exchange Act, not more frequently than quarterly. The holding company regulator should be authorized to establish lesser reporting requirements for reports to it and, in particular cases where warranted by individual circumstances, greater reporting requirements.

The holding company itself should be required to submit only the periodic reports required by the SEC for public companies under the

[34]The provisions set forth in Recommendations 2.9-2.12 are set forth more specifically in the Administration's proposed FIDA legislation.

Exchange Act, and comparable information for privately-held holding companies. Copies of such reports should also be submitted to the FDIC.

2.10 - Streamlined Application Procedures for Bank Holding Companies

The procedures under the BHCA should be streamlined to reduce discretionary approval requirements for individual transactions as proposed in FIDA. Each regulatory agency supervising bank holding companies should establish procedures for reviewing applications under the BHCA in a manner consistent with FIDA.

2.11 - Simplified Formation of Bank Holding Companies

The present requirements of the BHCA for prior approval for formation of a bank holding company should be eliminated (as provided in FIDA), and an exemption should be available from the registration requirements of the Securities Act of 1933 where a new holding company is to be owned by the same individuals that previously owned the bank(s) to be owned by the holding company. The new bank holding company should also have to meet the capital and other financial standards of its bank holding company supervisor and, at the time of the reorganization, the bank could not be engaged in activities other than banking.

2.12 - Elimination of Holding Company Controls on New Offices and Other Matters of Corporate Housekeeping

Except for individual restrictions for supervisory reasons, there should not be any limitation on opening of new offices, relocations or other matters of corporate housekeeping affecting bank holding companies or their non-banking affiliates.

Discussion of Recommendations

The most efficient manner of regulating bank holding companies has not been a frequent or prominent subject of review by earlier studies of the federal bank regulatory system. One reason for this neglect was the small number of bank holding companies. Indeed, as recently as 1970 there were only 121 such companies in the entire nation. Another reason for the inattention to holding company regulation in previous studies may be that, from the government's perspective, the regulation of all U.S. holding companies by a single agency has appeared to be a "simple" and coherent regulatory structure. However, in practice the system has resulted in an additional regulatory agency for many banking organizations, thereby complicating rather than simplifying the supervisory system in the view of many.

One of the principal motivations for enactment of the Bank Holding Company Act of 1956 was the desire by Congress to prevent banks from acquiring "commercial" firms (and vice versa) or engaging in most non-banking businesses through the holding company device. Another principal motivation was to limit the interstate expansion of affiliated banking organizations. These objectives do not require any particular agency to handle supervisory responsibilities under the statute.

Under the current system, the FRB determines the permissible activities for all bank holding companies, acting both through general regulations and orders applicable to specific institutions. This authority is exercised exclusively by the FRB, with no direct participation in this decision-making by any other government agency.

In addition to its role in determining permissible activities, the FRB also has jurisdiction to examine and supervise every bank holding company, irrespective of the charter type of its subsidiary bank(s) or whether the organization engages in <u>any</u> non-banking activities. Pursuant to this authority the FRB must approve in advance the formation of a bank holding company, the opening of most of its offices and all acquisitions of other businesses. The FRB must also approve any holding company's plan to commence a new type of non-banking business on a <u>de novo</u> basis, even where the <u>type</u> of business is expressly permissible under the FRB regulations.

In passing on applications to commence or acquire new businesses, as well as to form new holding companies, the FRB must review, among other factors, the financial and managerial capabilities of the specific company. Where the banking subsidiaries of such firms are national or state non-member banks, however, the FRB is not likely to have any on-going first-hand experience relative to the particular firm concerning these issues. While the FRB always consults with the OCC, FDIC and state agencies in fulfilling its responsibilities, it is nevertheless in the position of developing for itself information that is already possessed by the supervisor of the subsidiary bank. Therefore, by separating holding company supervisory responsibilities from that of supervision of the underlying bank(s), the current system creates significant and unnecessary inefficiencies in some cases.

Since enactment of the BHCA nearly 30 years ago, the number of registered bank holding companies has grown explosively. From the 53 original companies, the number of registered bank holding companies has grown more than 10,000 percent, with the total now almost 5,400 companies and still increasing rapidly. Even as late as the time of the 1970 Amendments to the BHCA, it was rare for a bank to be part of a holding company. In less than 15 years this pattern has been largely reversed, and at present over 50% of all U.S. banks (holding more than 80% of U.S. bank assets) are now owned by their shareholders through the holding company format. It is reasonable to assume that this trend to holding company format will continue over the next few years, especially if Congress enacts the Administration's proposed legislation to broaden the permissible financial activities of bank holding companies. As a result, almost all U.S. banks may eventually become part of holding companies, and even now the holding company has become the dominant organizational form of the U.S. banking industry.

The growth in the number of holding companies has occurred for a variety of reasons that are often not germane to any supervisory issue, such as for tax or estate planning purposes. Indeed, it is estimated that less than 20% of the almost 5,400 holding companies engage in any type of non-banking businesses, while the vast majority of such companies are simply financing vehicles for the subsidiary bank(s). In such cases virtually all the consolidated assets of the overall organization are actually held in the bank subsidiaries, which are of course already regulated by the OCC, FDIC or FRB. In addition, most of these firms are quite small, with approximately 40% having $25 million or less in assets, and 80% with $100 million or less.

With the large growth in use of the holding company form of organization, most of these companies have become subject to FRB regulation in addition to regulation by the OCC or FDIC of the subsidiary banks.[35] Because a bank and its holding company are in fact a single organization, however, the result is a supervisory system in which responsibility is fragmented between two different federal agencies, with no single agency responsible for the entire organization. This bifurcation of regulatory responsibilities creates a risk that supervisory issues will not be adequately perceived by either regulator due to its partial responsibilities, much as may have occurred in recent cases of failure of chains of banks under common ownership but not common supervision or examination. This risk is mitigated, but not completely eliminated, by the FRB's practice of soliciting comments from the primary supervisors of subsidiary banks on all holding company applications and supervisory actions.

In addition to the risks created by shared supervision over a single organization, the system results in significant additional regulatory burdens for private firms due to the necessity of complying with two different agencies rather than only one. Thus, formation of a new national bank and its acquisition by a holding company today requires two separate approvals from unrelated federal agencies, each applying essentially the same standards to the same transaction. Similarly, the merger of two national banks and their holding companies requires the independent prior approval of both the OCC and FRB before the transaction may occur. Even though the legal issues under review in such matters may differ slightly, in both cases substantial time and legal and other expenses could be avoided if a single agency had authority to act on the entire transaction (See Figures 11 and 12 in Part I hereof).

The Task Group has proposed eliminating the current fragmented system under which banks and their holding companies are generally regulated by different agencies. In its place, a new system would be established under which in almost all cases the regulation of a bank and its parent holding company would be unified under a single federal agency. Under this proposal, the Federal Banking Agency would regulate national banks and their holding companies, while the Federal Reserve would regulate state-chartered banks and their holding companies.[36]

---

[35]Approximately 93% of the nation's commercial banks are regulated by the OCC or FDIC, while roughly 7% are state member banks regulated by the FRB. Under the current structure only the state member banks have the same federal regulator for their bank and holding company.

[36]To the extent that state agencies become fully "certified" under the program described elsewhere in this Report, a state-chartered bank and
(Footnote Continued)

By centralizing the regulation of the entire banking organization under a single agency, the Task Group proposals would both simplify regulatory proceedings for regulated firms and, at the same time, offer the potential for strengthening the overall supervisory process. Unlike today, in most cases a single regulatory agency would have full supervisory jurisdiction over the entire banking organization, rather than simply one or the other of its constituent parts. Also unlike today, only one agency would be required to approve mergers or acquisitions involving a particular banking organization, rather than the two or even three agencies that may be involved today. Similarly, the approval of only one agency would be required to establish a bank and parent holding company, rather than the two approvals generally required today.

The "unified" system of regulation proposed by the Task Group is, from a conceptual point of view, far more justifiable than the status quo. Under federal law, there is not any regulation of holding companies per se of securities, insurance, commodities or other types of financial firms. Even holding companies of savings and loans, which have the only other federal holding company statute, are in most cases virtually unregulated. By contrast, bank holding companies are extensively regulated in virtually all of their operations.

Special regulatory controls exist for bank holding companies because of the unique role of banks in the national economy, and the possibility that adverse financial results in the holding company or one of its non-banking affiliates might endanger the solvency of its subsidiary bank(s). The paradox of the current system is that while the threat of any such adverse financial impact on the bank is the principal justification for the scheme of regulation, the agency with express responsibility for supervising the solvency of the bank usually does not have authority over its parent holding company or the non-banking affiliates from which a financial threat might emanate. While the FRB is responsible for regulating the parent company and its affiliates, in most cases it has no direct supervisory responsibility for the solvency of the subsidiary banks of the holding companies that it regulates.

The Task Group proposals would improve this allocation of responsibilities. In most cases the agency charged with supervising the solvency of the banking institution would have direct supervisory authority over all of that bank's affiliated companies. The appropriate bank supervisor would, therefore, have authority over all transactions that might affect the solvency of the integrated organization, whether or not such transaction was being conducted through the bank or through a related holding company affiliate. Therefore, there would be no ability to "forum shop" between regulators by assigning transactions to a holding company or to the subsidiary bank.

(Footnote Continued)
its holding company could also be exclusively supervised and examined by its state regulatory agency rather than the FRB.

Under the Task Group's proposals, there would be two exceptions to the unification of regulation of banks and their holding companies. As proposed by the Task Group, the FRB would continue to supervise and examine all "international class" holding companies. These institutions would include (i) any U.S. banking organization engaged in a full domestic banking business in a foreign country, (ii) domestic organizations with more than one-half of 1% of the total aggregate holding company assets (approximately $12½ billion at the current time), and (iii) all bank holding companies under foreign ownership. Of the 50 companies which would qualify today under (i) and (ii) above, 35 are anchored by national banks. Therefore, for these 35 institutions there would continue to be a different regulator for the holding company than for the national bank subsidiary.

The second exception to the general principal of unified bank and holding company regulation is in the case of multi-bank holding companies that have both national and state-chartered subsidiary banks. In that case, one agency would regulate the state-chartered banks, while a different agency would regulate the nationally-chartered banks. The holding company in such a situation would be subject to the regulator of the largest subsidiary bank. Any such company desiring a single federal regulator could, of course, simply convert all its subsidiary banks to the same form of charter, either national or state. The lead bank and holding company regulator would also be in a position to coordinate examination of all the organization's subsidiary banks with their supervisory agencies.

In addition to centralizing supervisory responsibilities over the bank and its holding company, the Task Group proposals would shift the responsibility for determining the permissible activities of all bank holding companies from the FRB to the new FBA. As a result, the FBA would in the future interpret the requirements of the BHCA relating to non-banking activities, either in its current form or as amended on passage of the currently pending Administration-sponsored legislation to expand the authorized powers of bank holding companies. While the power to establish the so-called "laundry list" and the regulations governing the conduct of any such activities would be transferred to the FBA, the FRB would maintain a right to veto either the laundry list or implementing regulations[37] in the event that a 2/3rds majority of the Board of Governors of the FRB found that any such proposal would have a seriously adverse affect on the banking system as a whole.

While the responsibility for establishing the permissible activities of holding companies would shift from the FRB to the FBA, subject to the FRB's veto, the establishment of prudential standards for holding companies (such as leverage ratios) would be a joint responsibility of the FRB and FBA. Indeed, under the Task Group's recommendations such prudential standards could not be changed by either agency without mutual

[37] The veto right of the FRB would also extend to individual orders approving new activities not previously approved by regulation.

concurrence. Similarly, the Task Group recommendations would require mutual consultation between the FBA and FRB concerning major policy issues concerning enforcement of the BHCA and would require reporting obligations to be consistent to the greatest practicable degree.

In addition, under the Task Group recommendations the current procedural requirements of the BHCA would be amended to reduce reporting requirements, streamline unnecessarily cumbersome obligations, simplify formation of bank holding companies and eliminate approval requirements for various day-to-day transactions, such as opening new offices. These proposals would codify several recent regulatory changes implemented by the FRB to streamline existing procedures, and they are all included in the current legislation pending before the Congress which is supported by the Administration, FRB, OCC and FDIC. These proposals relating to bank holding companies have the unanimous support of all the members of the Task Group, and any banking legislation relating to regulation of bank holding companies would be deficient without including such proposals.

III. REFORM OF DEPOSIT INSURANCE SYSTEM

A. Reform of the Deposit Insurance System

3.1 - Maintenance of Separate Insurance Funds At The Present Time

The existing deposit insurance funds should continue to be maintained at this time by the FDIC, FSLIC and NCUSIF.

3.2 - Common Capital Requirements and Accounting Standards

Congress should require the FDIC and FHLBB to adopt common minimum capital standards and common accounting rules to determine such minimum capital for depository institutions insured by each such agency (including the FSLIC in the case of the FHLBB). These common standards for insurance purposes should be implemented by each agency as soon as practicable, but Congress should establish a fixed date (such as 7 years from the enactment date of legislation) at which time the implementation of such standards would have to be completed. However, each relevant supervisory agency should retain authority to vary such standards in the event of industry-wide financial difficulties, as well as normal discretion over individual supervisory cases. Congress should designate a third party (for example, the Secretary of the Treasury) to resolve remaining disputed issues if the agencies do not agree on standards within a required period.

3.3 - Risk-Sharing for Uninsured Deposits

There should be a change in current practices under which uninsured deposits of an institution that is merged or consolidated with another institution in a transaction assisted by a federal insurance fund are assumed in full by any successor organization. In any such case, deposits above the limits of the federal insurance coverage should be limited to assumption by any successor organization at no more than an appropriate fraction of their principal amount, with the balance represented by receivership-type certificates. However, legislation to implement this recommendation should provide for delayed effectiveness of a suitable length to permit a measured transition to the new system.

3.4 - Risk-Related Deposit Insurance Premiums

The FDIC and FSLIC should be authorized, but not required, to institute systems of risk-based insurance premiums, provided that any such system should include utilization of independent private sector indices of risk to the extent feasible.

Discussion of Recommendations

Under the current system there are three different federal deposit insurance programs for banks, thrifts and credit unions. These programs are administered by the FDIC, FSLIC (a part of the FHLBB) and the NCUSIF (a part of the NCUA), respectively. Among the issues reviewed by the Task Group was the desirability of merging these three separate insurance programs into a single agency. The Task Group concluded that any such proposal would be premature at this time, in light of the continued differences in both financial condition and the nature of insured risks among the different types of insured organizations. While no merger of the insurance funds was recommended, the Task Group adopted several other recommendations to strengthen the current system.

Common Capital Levels. The Task Group noted the current difference between the FDIC and FSLIC in the minimum capital required in order to be eligible for the respective deposit insurance programs. While it has historically required a 5% minimum capital level, as a result of the extreme financial condition experienced by many thrifts during the periods of extraordinary high market interest rates the FSLIC reduced its minimum capital requirements from 5% to only 3%. Indeed, a large percentage of thrift institutions do not meet the lower 3% requirement, or do so only by utilizing regulatory accounting practices that are not consistent with generally accepted accounting principles. However, the FDIC presently requires a minimum of 5% capital, which it has proposed raising to 6%. The FRB and OCC separately establish capital levels for state member and national banks, respectively, although these agencies each require a minimum capital level comparable to that of the FDIC.

The degree of leverage in the capital structure of a depository institution has a direct bearing on the ability of any such institution to withstand periods of adverse earnings. While capital is not a substitute for healthy earnings, it is an essential requirement in maintaining the stability of any single institution or of the banking system as a whole.

In a system free of government limits on interest levels, the degree of leverage of a depository institution directly affects the pricing of its products. For example, an institution with lower capital can maintain the same return on equity to its shareholders while simultaneously offering higher interest rates on deposits than a more conservatively capitalized institution would be able to offer at a common rate of return on shareholders equity. Therefore, there is a built-in competitive advantage from a pricing perspective to having less capital. Lower capital levels may also create inducements for certain individuals to attempt to utilize insured institutions to achieve large gains through high-risk speculative activities, with possible significant losses being imposed on the insurance funds due to the low level of private capital in the institution.

To the extent that depositors and other creditors are reassured by government backing of deposits, institutions may be tempted to maintain lower capital than would otherwise be prudent. Different levels of minimum capital between separate government insurance programs involves, therefore, the creation of a competitive advantage for one type of institution which can be realized only if the institution is capitalized in a more risky fashion.

To remedy this situation, the Task Group has recommended that the FSLIC and FDIC be required to establish jointly common minimum capital levels for their respective insurance programs. Due to the earnings difficulties and impaired capital position of many thrift institutions, the Task Group recognized that thrift institutions will require an adequately long period of time (e.g. 7 years) to attain higher minimum capital standards. However, the necessity of raising capital to prudent levels over time must be recognized in order to preserve the financial integrity and stability of our depository institutions. Indeed, higher capital levels would increase the safety and soundness of the financial system by (i) reducing the number of failed institutions, (ii) reducing losses to the insurance funds and (iii) reducing incentives for highly speculative activities by insured institutions.

Risk-Related Insurance Premiums. Under the current system, deposit insurance premiums are based solely on the volume of insured deposits, with no variation among insured institutions based on the level of risk that any such institution may pose for the insurance agency. At present the very strongest bank pays the same premium rates as a highly troubled or undercapitalized firm, even though it represents a far lower risk for the insurance fund. Indeed, the current system in effect forces prudently managed institutions to subsidize high risk institutions through unrealistically low insurance premiums. While few can imagine a private life insurance program that disregarded age and health history in establishing premiums, this is precisely how the deposit insurance system operates.

To improve this situation, the Task Group recommendations would authorize the FDIC and FSLIC to establish risk-based variable insurance premiums. Under this proposal, institutions that choose to engage in activities with a broader spectrum of risk would be required to pay appropriately higher insurance premiums as a result. However, to guard against abuse, the Task Group recommends that the insurance agencies should be required to utilize measurements of risk developed by the private sector to the greatest possible degree. This recommendation would also permit variation in basic premium levels, rather than simply in premium rebates.

The Task Group recommendation regarding risk related insurance premiums would strengthen the deposit insurance system by permitting more realistic pricing of insurance protection. It would also encourage more prudent behavior by insured institutions by eliminating the current premium penalty for safer firms. Finally, it would improve the stability of the financial system as a whole by creating a disincentive for institutions to engage in excessively risky activities.

B. Responsibilities of the FDIC

3.5 - Organization of the FDIC

The FDIC should remain an independent insurance corporation with a board whose voting members should consist of three Presidential appointees. However, the Director of the FBA and the Chairman of the FRB[38] should serve as non-voting members and should be entitled to attend all board meetings of the FDIC.

3.6 - Activities of the FDIC

The role of the FDIC should be limited by law to providing deposit insurance, with no general supervisory authority unrelated to the operation of the deposit insurance system. More specifically, all the current responsibilities of the FDIC for establishing or enforcing regulations applicable to state-chartered banks concerning consumer protection, civil rights, historic or environmental protection, trust powers, branching and other functions not relating to insurance concerns, together with all routine examination, supervision and regulation of state non-member banks, should be transferred to the FRB, or to the states to the extent particular states are certified. However, the FDIC should receive copies of all examination and call reports prepared by or filed with the supervisors[39] of any bank insured by the FDIC.

3.7 - Examination Authority of the FDIC

Current FDIC authority to examine banks for insurance purposes should remain unchanged, and the FDIC should have the right (i) to examine, in conjunction with the primary supervisor, institutions insured by it (whether state or federally chartered) that are troubled, as well as a limited sample of non-troubled institutions, and (ii) to accompany the primary supervisor on other examinations of non-troubled insured

---

[38]Or a designee from among the statutory deputies at the FBA or the members of the Board of Governors of the FRB.

[39]"Supervisor" as used herein means the FBA, FRB or state authorities, as the case may be.

firms.[40] In all examinations of troubled and non-troubled firms, the FDIC should utilize the same format for data normally utilized by the supervisor of any such institution.

3.8 - Enforcement Authority of the FDIC

The FDIC should retain its current authority to revoke insurance for both state and federally chartered institutions (or raise premiums where a system of risk-based insurance premiums is in effect) engaging in unsafe or unsound practices. In addition, the FDIC should have the authority to request the relevant supervisor to take any other enforcement action applicable to any insured bank or its officers and directors. Where the supervisor declined to take such action the FDIC should be entitled to initiate such action independently if the FDIC Board of Directors, based upon an examination of any such bank by the FDIC, determines such action to be necessary under statutory standards relating to unsafe or unsound banking practices by an insured bank or its management.

3.9 - Applications for Insurance

The FDIC should continue to review applications for insurance from state-chartered non-member banks, subject to appropriate deferral (as described for national and member banks) to the extent certified states are involved. In the case of applications for a national bank charter or by a newly-chartered or uninsured state bank for membership in the Federal Reserve System, the FBA or FRB, as the case may be, should furnish a copy of the individual application submitted to either such agency to the FDIC for its review. In reviewing any such application for insurance or which would otherwise convey insurance, the FDIC should be limited to consideration of the financial and managerial resources of the bank and its organizers. The FBA or FRB, as the case may be, should advise the FDIC of its determination regarding such factors, and in the normal course the FDIC should rely on such determination by the FBA or FRB. In any event where the FDIC does not concur in any such determination by the FBA or FRB, it should be required to advise promptly either such agency that it intends to decline to provide insurance coverage.

Discussion of Recommendations

The Task Group recommends a substantial reorientation of the current responsibilities of the FDIC. Although created to provide deposit insurance, the FDIC has assumed a wide variety of additional responsibilities over the 50 years of its existence. In most respects these additional tasks are unrelated to the solvency of insured institutions and any risk that they might pose to the deposit insurance fund. While these corollary responsibilities are important for some agency to perform, the FDIC

[40] In each case such examinations should be handled in a manner comparable to that provided in the recent agreement for coordinated examinations of national banks between the OCC and FDIC.

may not be the most appropriate agency to enforce environmental, consumer protection or other laws not relating to its insurance programs.

In the field of bank examination, the FDIC today has responsibility for supervising, on a day-to-day basis, approximately 9,000 state non-member banks. These non-member banks hold approximately 20% of aggregate U.S. bank assets. The FDIC spends more than $800 million per decade in examining these banks, even though all of them are examined by state agencies, and most are perfectly healthy and represent no danger to the FDIC fund. On the other hand, the FDIC has not historically examined national banks or member banks that were troubled and may have represented a far more direct exposure for the FDIC insurance program.

Under the Task Group proposals, the FDIC would transfer to other agencies all supervisory responsibilities not directly related to operation of the deposit insurance program and responsibility for examining healthy state non-member banks. In place of its current role as a general purpose regulator, the Task Group recommendations are designed to provide the FDIC with the authority to serve as a true watchdog of the insurance program.

Refocused to serve functionally as an insurance company, the FDIC would have authority to review applications for insurance,[41] to examine all troubled institutions (and a sample of non-troubled firms) in conjunction with their primary supervisor, to revoke insurance of any insured bank and to take other enforcement action against violations of federal laws regarding unsafe banking practices in the banks that it examines. Working cooperatively with the FBA, FRB and state authorities, the FDIC would be responsible solely for the safe, sound and efficient administration of a deposit insurance system.

IV. ALLOCATION OF FEDERAL AND STATE REGULATORY ACTIVITIES

4.1 - Transfer of Certain Federal Oversight Responsibilities to the States

As more fully described in Appendix C, a new "certification" program should be established under which states would assume existing federal examination and supervisory responsibilities over state-chartered depository institutions (i) to the degree and extent that individual states may desire and (ii) where, in the judgment of the responsible federal

---

[41] Applications under the Change in Bank Control Act ("CBCA") present a situation that is in some respects analagous to other applications that result in the issuance of federal deposit insurance. Thus, there would be obvious issues as to which the FDIC would have an institutional interest. However, the Task Group principals did not review the current enforcement authority under the CBCA or recommend any changes thereto at the present time.

agencies,[42] any such state has developed supervisory programs that are comparable (at least in a particular area) to those of the relevant federal supervisory agencies. The certification program should be designed to establish a flexible process for transferring federal supervisory authority to the states to the maximum degree practicable and prudent, subject to appropriate residual regulatory authority of the FRB[43] or FHLBB, and insurance authority of the FDIC or FSLIC.

4.2 - Maintenance of Existing Relationships in States With Limited Supervisory Programs

For states where the appropriate federal agency did not find that state examinations are equivalently reliable to those of the relevant federal agencies, federally-insured state-chartered institutions should be examined by the appropriate federal supervisory agency (the FRB in the case of banks and the FHLBB in the case of thrifts) in addition to its state regulator as under current practices, including alternate year examination programs.

4.3 - Training and Technical Assistance

The various federal examining agencies should be authorized to provide training and technical assistance to states desiring to enter into a multi-year program designed to lead to FRB or FHLBB certification of state examination programs.

4.4 - Facilitation of Cooperative Interstate Examination by States

The Congress should mandate cooperation by Federal examining agencies with any cooperative interstate examination agency established independently by the states or by the private sector.

4.5 - Local Advisory Councils

A formal "State Advisory Council" should be established to advise each Federal Reserve Bank, and through it the FRB, on issues affecting coordination of state and federal supervision and examination activities, including questions relating to the scope of certification of individual states. Similar Regional Advisory Councils should be authorized for the FBA and FDIC to advise on performance of the responsibilities of such agencies.

---

[42] The FRB in the case of banks and FHLBB in the case of thrift institutions insured by the FSLIC.

[43] The FRB's current responsibilities and authority relating to operation of the discount window should remain unchanged.

4.6 - Federal Deposit Insurance Availability for State-Chartered Institutions

Federal authorities should not be under any obligation to utilize deposit insurance funds contributed by institutions throughout the country to insure the deposits of state-chartered institutions which create significant risks for the deposit insurance funds through unsafe or unsound practices. Consequently, the FDIC (as is authorized under current law) and FHLBB should be authorized to limit the availability of deposit insurance for state-chartered institutions where, in making use of authorities granted under state law, any such institution engages in unsafe or unsound practices.

4.7 - State-Chartered Institutions with Purely Extraterritorial Powers

While the states have always had the authority to determine independently the activities that may be engaged in by state-chartered institutions, Congress should specifically review the desirability as a matter of federalism of permitting states to confer such authorities for use in other states while simultaneously restricting their use within the authorizing state.

Discussion of Recommendations

Under the current system, the FRB or FDIC have jurisdiction to examine and supervise all state-chartered banks which are either members of the Federal Reserve System or insured by the FDIC. Therefore, virtually all state-chartered banks in reality have two supervisors, one at the state level and a second at the federal level. State non-member banks with a holding company would also have the FRB as a third regulator for their holding company. This system can result in a single bank being examined three times a year by different agencies and its own accountants, together with a possible fourth examination for its holding company. Although the FDIC and FRB have both adopted alternative year examination programs with slightly more than one-half the states to reduce dual examinations by both federal and state agencies in the same year, there is still substantial overlap in bank examinations.

For any state that can conduct an examination that is equivalently reliable to that of its federal counterpart, there is no public purpose served by repeating at the federal level the examination already conducted by the state. Rather than preoccupying themselves with examinations of healthy state-chartered institutions in states with the highest quality regulatory programs, the federal agencies should focus their efforts more intensely on state-chartered institutions in states that do not have adequate supervisory programs of their own, as well as on troubled institutions in danger of failure and other special situations.

Therefore, the Task Group recommends the creation of a new "certification" program. Under this program much of the current federal authority for state-chartered banks and their holding companies could be turned over to state agencies that have supervisory programs which are equivalently reliable to those of the federal agencies. Under this program states would be able to assume full regulatory responsibilities, without federal duplication, for all, or only certain sizes and types, of state-chartered banks and their holding companies.

Under this proposal, the criteria for certification of bank regulatory programs would be jointly developed by the FBA, FDIC and FRB in a rulemaking proceeding with full notice and public comment. Input from the state regulatory agencies should be specifically encouraged as part of the rulemaking proceeding. The FRB, in consultation with the other agencies (as well as the relevant peer review committees of state regulators), would make the final decision to certify or decertify a particular state at a specific level, although the determination to certify a state would be subject to veto by the FDIC. Certification criteria and decisions for thrift regulatory programs would be determined in a comparable manner by the FHLBB.

Each state would decide for itself the "level" at which it desired to assume existing federal supervisory responsibilities. For example, a state could seek certification for all banks with assets below a particular asset size (e.g. $300 million or $500 million, etc.) or based on operating criteria (e.g. banks without foreign operations). Similarly, a state could seek certification to supervise all, or only certain sizes of holding companies, or those with only intra-state non-banking activities.

Certified state regulatory agencies would, of course, be subject in all respects to the substantive requirements of federal law. One important element in deciding on state eligibility for certification would be the state's ability to insure compliance with federal law. For example, no state agency could authorize holding companies to engage in specific activities that were not permitted under federal law. In fact, to be certified for holding company supervision a state would have to adopt a statute not less restrictive than the federal holding company statute.

While states would not be free to abrogate substantive federal law applicable to all bank holding companies, to the extent they were so certified state agencies could administer and enforce the BHCA, including acting on applications or notifications by holding companies desiring to engage in permissible activities. Similarly, a principal criteria for the certification of states to conduct compliance examinations under federal consumer legislation would be the adequacy of state systems to detect violations of federal law to an equivalent degree to that of federal agencies.[44]

At the same time that incentives would be created for states to assume more complete responsibility for regulating state-chartered institutions, the authority of the federal government to proscribe unsafe or unsound practices by any insured institution would be reaffirmed under

---

[44] States are authorized to enforce a wide variety of federal statutory programs pertaining to occupational safety and health, strip mining, air and water pollution and many other areas.

the Task Group's recommendations. While only the state legislature can determine the appropriate content of substantive state banking law, there should be no inherent obligation on the part of the federal insurance agencies to underwrite unsafe practices by any institution, whether or not permitted under state law. However, the touchstone for review should be whether unsafe practices exist, rather than whether a state authorizes activities that are different in some respect from those provided under federal law. The ability of the states to experiment with better ways to serve the consumer should not be impaired unless necessary to protect the integrity of the deposit insurance programs or to assure safety and soundness of the overall banking system.

V. FUNCTIONAL REGULATION, STREAMLINING OF UNNECESSARY REGULATORY CONTROLS AND EQUALITY OF COMPETITION

A. Implementation of Greater Functional Regulation

5.1 - Centralization of Antitrust Responsibilities

The Bank Merger Act ("BMA") should be repealed, with all anti-competitive analysis performed by the Department of Justice, utilizing normal antitrust standards (including existing size cut-offs under the Hart-Scott-Rodino Act). The appropriate federal supervisory agencies should review merger/acquisition notifications solely for safety and soundness considerations. Notwithstanding the application of normal antitrust standards, supervisory mergers should continue to be exempt from prior Department of Justice review. The automatic stay and limited period for the Department of Justice to sue under current law should also be retained.

5.2 - Centralization of Securities Responsibilities

The registration requirements of the Securities Act of 1933 should be made applicable to publicly offered securities of banks and thrifts (but not deposit instruments), and administration and enforcement of disclosure and other requirements of the Securities Exchange Act of 1934 for bank and thrift securities should be transferred from the bank and thrift regulatory agencies to the SEC, as is currently the case for securities of all other types of companies (including bank and thrift holding companies). The Federal Home Loan Bank Board, however, should exercise securities jurisdiction over conversions of savings and loan associations and federal savings banks from the mutual to the stock form of organization and other matters involving the safety and soundness of insured institutions or affecting the operations of the Federal Savings and Loan Insurance Corporation.

5.3 - Automatic Margin Eligibility for National Market System Stocks

All NASDAQ National Market System stocks should be automatically margin-eligible, as are securities listed on securities exchanges, unless removed from eligibility by action of the SEC. This would revise the current system under which margin eligibility for OTC stocks is limited to a list of approved securities published periodically by the FRB.

5.4 - Transfer of Margin Responsibilities for Options on Financial Instruments

Without prejudice to the desirability of further changes to margin regulation in general, which should be considered following completion of current studies in progress, the current procedures under which margin requirements for options on financial instruments (other than options on individual equity securities) are established by appropriate securities exchanges (subject to SEC veto), rather than by the FRB, should be codified by amending Section 7 of the Securities Exchange Act to eliminate FRB authority over such instruments.

Discussion of Recommendations

Under the current system, the Department of Justice and the OCC, FDIC, FRB and FHLBB are responsible for reviewing the anti-competitive implications of mergers and acquisitions involving banks or thrifts or their holding companies. The result is that mergers involving such firms are subject to an antitrust review by both the Department of Justice and the relevant financial agency, rather than the single review applied to all other types of companies. In addition, the three banking agencies may differ in their interpretation of the Bank Merger Act and the competitive standards applicable to bank or holding company transactions.

To reform this unnecessarily cumbersome system, the Task Group recommends that normal antitrust standards should apply to mergers and acquisitions involving banks and thrifts. This would eliminate the special competitive criteria in both the BMA and BHCA. While special substantive antitrust standards for banks may have been justified during an earlier era, as banks increasingly engage in a wider spectrum of financially-oriented activities the continuation of such differential antitrust standards is increasingly unsupportable as a matter of public policy.

Under the Task Group proposals, the Department of Justice would apply normal substantive antitrust standards under the same procedures applicable to other types of companies, with special provisions limited to supervisory mergers and the maintenance of the automatic stay and limited period for suit under current law. In the special case of supervisory mergers the Department of Justice should have an opportunity to comment to the appropriate supervisory agency on the competitive effects of such a merger prior to its completion to the extent possible under the circumstances. By placing antitrust regulation on a functional basis, banks and thrifts would be treated identically to other types of firms for antitrust purposes, and the antitrust divisions of the four bank and thrift agencies would be abolished.

Similarly, the Task Group recommends that all banks and thrifts publicly issuing securities (but not deposit instruments) to the investing public should be subject to the registration requirements of the Securities Act of 1933, and that administration and enforcement of disclosure requirements under the Securities Exchange Act of 1934 should be transferred exclusively to the SEC. Under the current system, the four bank and thrift agencies each maintain a separate securities division to perform the responsibilities otherwise handled by the SEC for all other types of companies. Like multiple agencies to review antitrust matters, this is an area of unnecessary duplication of government resources. Therefore, the Task Group recommends centralizing all enforcement responsibilities under the 1933 and 1934 Acts in the SEC.

The issuance of securities by thrift institutions sometimes differs from securities offerings by other financial institutions because of the unique mortgage-related nature of many types of thrift securities. For example, thrifts issue a variety of securities that represent interests in pools of mortgages, that pay through to their holders based upon payments in a pool of mortgages, or that are collateralized by mortgages. Thrifts also have developed other debt and equity financing techniques that use mortgage-related securities that have been obtained in exchange for mortgages in their portfolio.

While other types of firms issue mortgage-backed securities that are registered with the SEC under the 1933 Act, such issuances by thrifts are unique because the mortgages backing such securities represent a principal component of the net worth of many institutions whose deposits are insured by the FSLIC. Thus, the nature of securities issued by thrifts may directly affect the assets available to the FSLIC in the event of insolvency or have other direct impacts on safety and soundness. Therefore, the FHLBB should have authority to limit securities offerings by thrift institutions that would adversely affect thrift safety and soundness or the FSLIC fund.

The Task Group recommends streamlining the current system for determining margin eligibility of OTC stocks that are part of the NASDAQ National Market System. At present OTC stocks become margin eligible only upon inclusion in a list published by the FRB three times a year, although all securities listed on a national exchange are automatically margin-eligible. As the OTC market is now larger than all securities exchanges except the New York Stock Exchange, the current system is unduly restrictive for the most actively traded OTC stocks. Therefore, for these National Market System stocks, prices for which are published daily in newspapers across the United States, margin eligibility would become automatic to the same degree as with securities listed on an exchange.

Finally, the Task Group recommends that responsibility for establishing margin requirements for options on financial instruments other than individual equity securities should be shifted from the FRB to the appropriate securities exchanges, subject to SEC veto. This would codify existing practices.

Most members of the Task Group also felt that the FRB's remaining margin responsibilities should be eliminated. Some members believed that such responsibilities should be transferred to the securities exchanges, subject to SEC veto, while others believed that margin controls should be abolished. However, despite strong support for such proposals no specific recommendations were adopted due to the pendency of a major study on margin regulation by the FRB staff. It was unanimously felt that proposals to alter the margin system should be further reviewed upon completion of the FRB study.

B. Streamlining of Unnecessary or Overbroad Regulatory Restrictions

5.5 - Elimination of Federal Approvals for Branch Locations

Unless otherwise required in an individual case for supervisory reasons, advance approval from, or notification to, any federal supervisory agency should not be required for a federally-chartered or insured institution to establish branches or install automatic teller machines (where permissible pursuant to state law in the case of banks).

5.6 - Interstate Branching Parity of National and State-Chartered Banks

National banks should have the same authority to branch interstate as state-chartered banks from the same state. While the basic intent of the McFadden Act was to give national banks in a particular state the benefit of branching rules for state-chartered banks in that state, the statute is written in a way to suggest that national banks have branching parity only within the state. Consequently, national banks may be denied the benefits in states which adopt reciprocal interstate branching unless the law is so amended.

5.7 - Parity Between National and State-Chartered Banks in Electronic Facilities

Without prejudice to the desirability of future changes in geographic restrictions on depository institutions, ATM machines installed by national banks should be treated as branches only to the extent that ATM machines of state-chartered banks are treated as branches, rather than the current requirement that such machines must be treated as branches even if not so defined by state law.

5.8 - Repeal of Statutory Capital Requirements for Branches of National Banks

The current requirement that national banks maintain a minimum "statutory" capital for each branch is obsolete and should be repealed.

5.9 - Small Institutions Exemption from CRA and HMDA

The Community Reinvestment Act ("CRA") and Home Mortgage Disclosure Act ("HMDA") should be amended to exempt smaller institutions with less than a specified amount of assets.

5.10 - Repeal of Obsolete or Unnecessary Requirements

Various obsolete and outdated requirements of current banking and securities laws should be repealed, as enumerated and described at Appendix B.

5.11 - Abolition of FFIEC

The FFIEC should be abolished as unnecessary. Meaningful agency consultation and cooperation can only be achieved on a voluntary basis, and the FFIEC has not increased the level of such cooperation.

5.12 - Reduction of Mutual Fund Shareholder Fee Litigation

Section 36(b) of the Investment Company Act of 1940 (the "ICA"), which provides for shareholder litigation against "excessive" advisory fees, has produced unnecessarily extensive litigation against mutual fund advisors. Consequently, section 36(b) should be amended to either (i) establish specific standards to guide the case-by-case decision-making of the courts, or (ii) to authorize the independent directors of a fund to approve advisory fees based on a "reasonable business judgment" standard without subsequent litigation.

5.13 - Sharing of Costs and Expenses of Related Mutual Funds

The ICA should be amended to permit the independent directors of mutual funds to adopt common plans of share distribution and cost sharing with related funds, in a manner determined to be fair by the independent directors, compared with the current requirement for prior SEC approval of such common plans.

5.14 - Repeal of Public Utility Holding Company Act

The Public Utility Holding Company Act should be repealed, as its objectives were satisfied many years ago.

5.15 - Elimination of Nuisance Litigation Under RICO

The Racketeer Influenced and Corrupt Organization Act ("RICO") passed in 1970 as part of omnibus organized crime legislation, authorizes civil suits for violations of RICO with treble damage awards and attorneys fees. Because "securities fraud" is one of the many offenses which can trigger RICO, it has been used increasingly in litigation concerning normal disputes between brokerage firms and their customers, as well as in litigation between banks and their customers over interest rate levels and other matters wholly unrelated to organized criminal activities. The statute should be amended to insure that its civil liability provisions are not misused by private parties in litigation involving financial institutions.

Discussion of Recommendations

A large number of the current substantive legal requirements applicable to banks, thrifts, securities firms and other providers of financial services are unnecessarily burdensome. In some cases these regulatory restrictions were ill-conceived at the time they were originally adopted. In other cases, the regulations may have been necessary at one time, but have now outlived any conceivable benefit to the public. In still other cases, regulations serve desirable policy objectives, but may be unnecessarily broad in their application and thereby create unnecessary costs.

While the Task Group did not attempt to perform a thorough review of all the substantive requirements of law applicable to all the different types of financial institutions, in the course of both reviewing public comments and considering the general regulatory structure, various specific areas of unnecessary regulatory burden became apparent. These included a diverse set of issues described in the specific recommendations, ranging from totally unnecessary federal controls on the location of otherwise lawful branches or teller machine installations to the flagrant misuse of RICO as a tool of strike suite litigation against financial firms with no connection whatsoever to the organized crime activity RICO was designed to deter. In each of the areas identified by the Task Group, the public interest would be well-served by reducing the unnecessary burdens created by current law.

C. Equality of Regulatory Treatment

5.16 - Application of Glass-Steagall Act Upon Passage of Deregulatory Legislation

If and only if new deregulatory legislation is enacted to expand the permissible securities activities of bank holding companies as provided in FIDA, the prohibition against affiliations between firms engaged in underwriting long-term corporate debt or equity securities and member banks should be extended to apply equally to (i) state-chartered banks which accept federally insured deposits, irrespective of membership in the Federal Reserve System, and their subsidiaries, and (ii) insured thrift institutions and their subsidiaries, irrespective of charter type.

Discussion of Recommendation

The Glass-Steagall Act was enacted to, among other things, prohibit affiliations between commercial banks and investment banks engaged in the underwriting and distribution of corporate securities. Many informed observers, including the Department of Justice, consider the Glass-Steagall Act to be an unnecessary and highly anti-competitive restraint, probably enacted due to misperception of the causes of the depression. However, other observers, including many members of the securities industry, consider the statute to be wise public policy even under today's market conditions. Irrespective of one's view of its desirability, the statute is an artificial separation of financial sectors which does not exist in most other industrialized nations.[45]

---

[45] In fact, the statute does not apply outside the U.S., and American banks are active in securities underwriting and distribution in London and other financial centers outside the U.S.

As an artificial separation of market sectors, the statute should be applied in an even-handed and across-the-board fashion if it is to continue as public policy in the United States. However, for reasons that remain in dispute, the express statutory language passed by Congress differs in the extent of restrictions applied to state banks that are members of the Federal Reserve System and those that are not. In a series of individual cases dating back more than a decade, and now through a proposed general regulation, the FDIC has taken the position that Glass-Steagall prohibits affiliations between investment banks and national banks and state member banks, but that it does not apply to affiliations with state non-member banks. This difference in application has resulted in the acquisition of banks by several full-service securities firms and underwriters, including the nation's second largest. It has also recently been utilized by certain non-member banks seeking to acquire securities firms as subsidiaries.

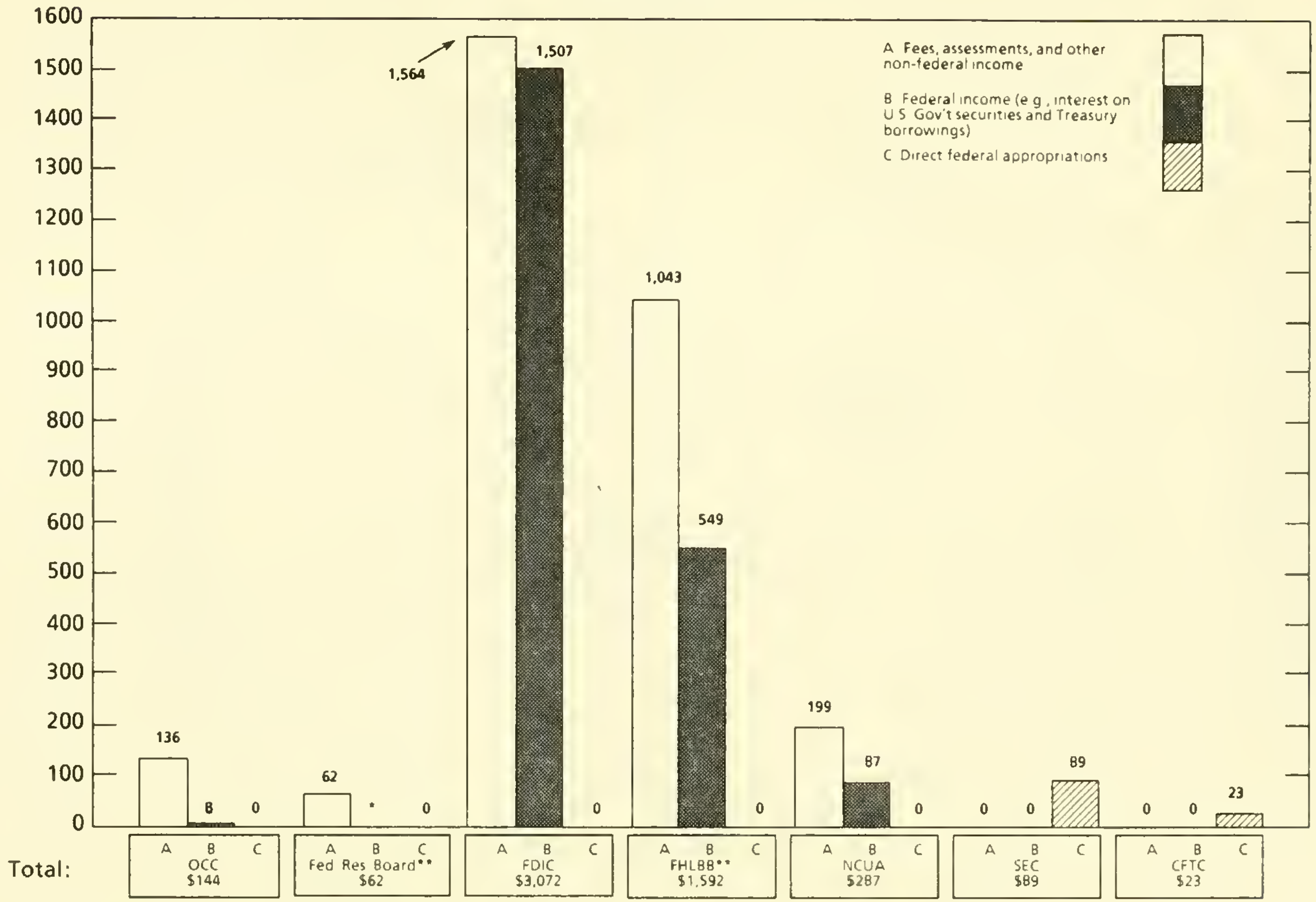
The application of this statute to some banks but not others, based solely on whether institutions are members of the Federal Reserve System, is indefensible. Either public policy demands that depository institutions be separated from companies engaged in the underwriting of corporate securities or it does not. In the context of a broadening of permissible securities powers of bank holding companies as proposed in the Administration's pending legislation, the Task Group supports an extension of the Glass-Steagall Act to all depository institutions, irrespective of membership in the Federal Reserve System. However, the Task Group did not recommend any legislation to extend the prohibitions against affiliations between banks and investment banks absent enactment of the proposed new legislation to broaden the existing securities activities of bank holding companies.

APPENDIX A

FIGURE 13

1983 Estimated Financing

($ in millions)

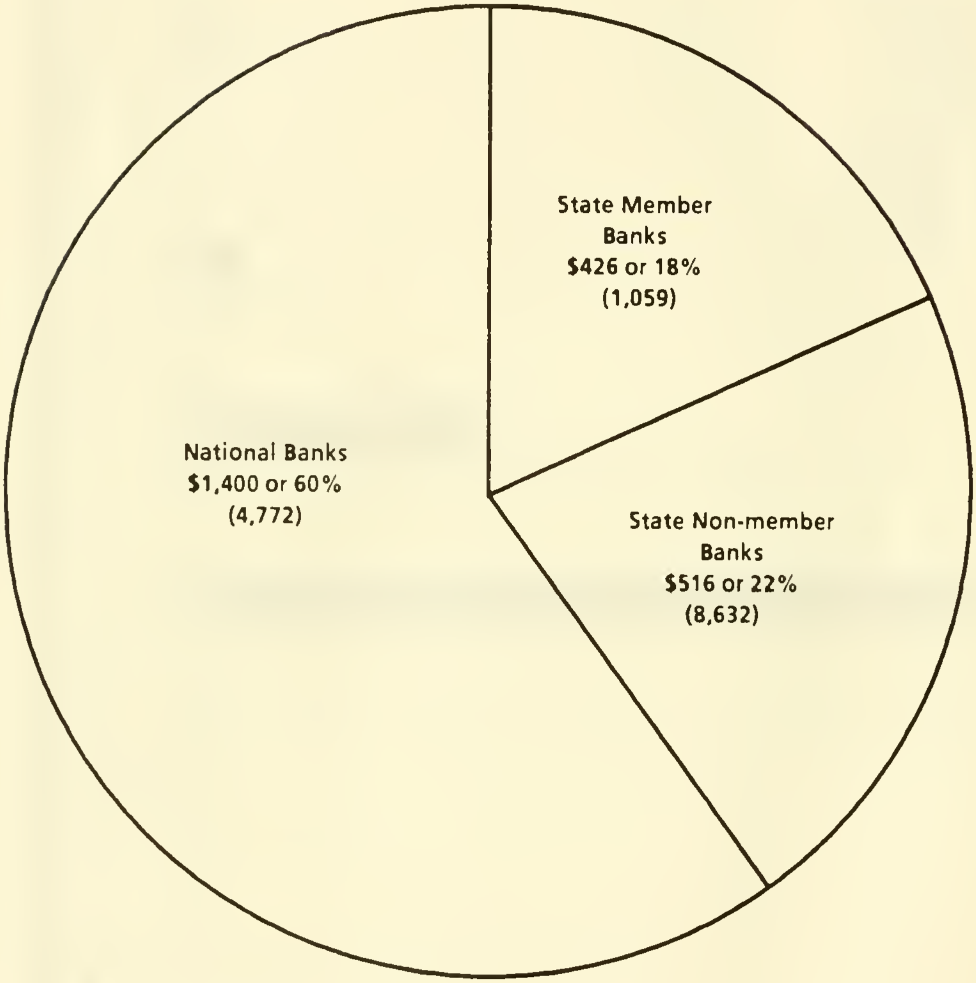


*Less than $0.5 million

**Excludes financing for the Federal Reserve Banks and the Federal Home Loan Banks. For 1982, the Federal Reserve Banks took in $16.5 billion ($15.5 billion in interest on U.S. Gov't. securities and $1.0 billion in fees, assessments, and other non-federal income). The Federal Home Loan Banks for the same year took in $56.2 billion ($1.3 billion in interest on U.S. Gov't. securities and $12.7 billion in fees, assessments, and other non-federal income net advance repayments). $3.3 billion in net new advances were also made during the year.

FIGURE 14

Distribution of Assets
and Numbers of Banks
(As of 12/31/83; $ in billions)



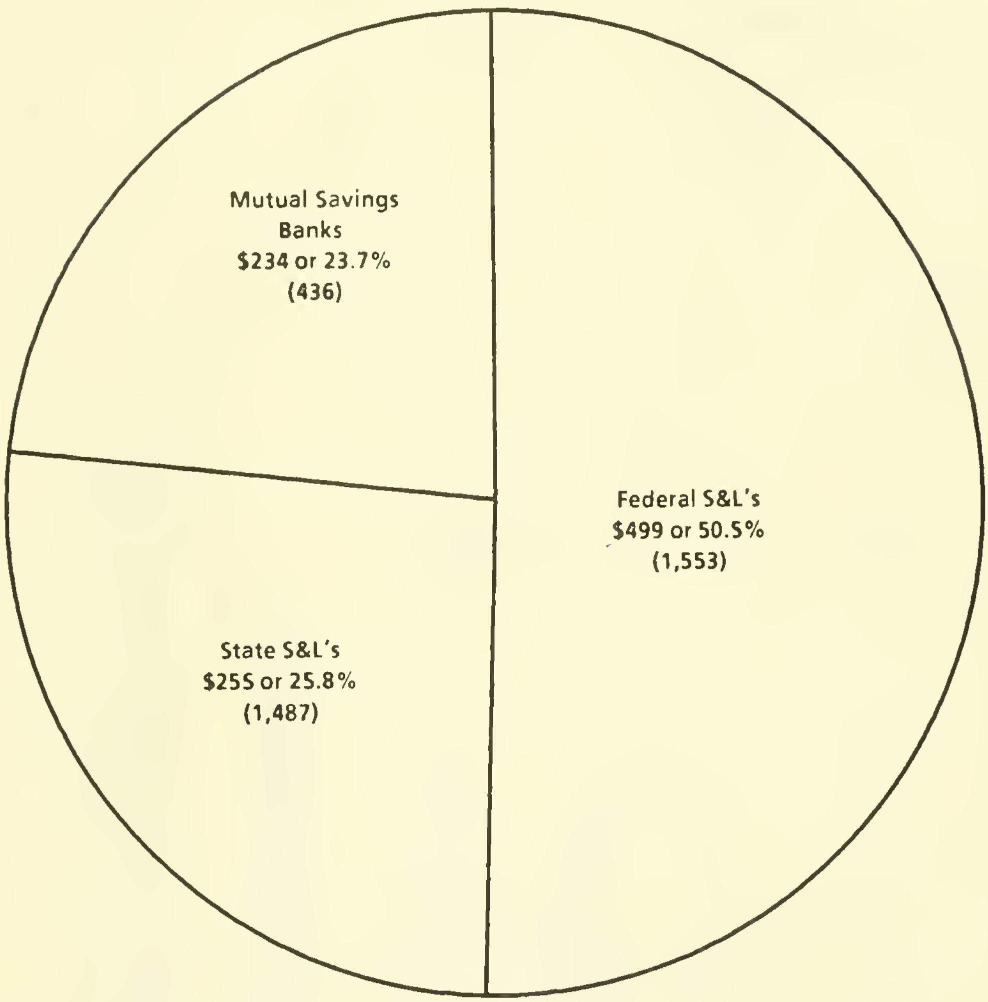
Total Banks = 14,463
Total Assets = $2,342 billion
(Excludes Mutual Savings Banks)

FIGURE 15

Distribution of Assets

and Numbers of Thrift Institutions

(As of 12/31/83; $ in billions)



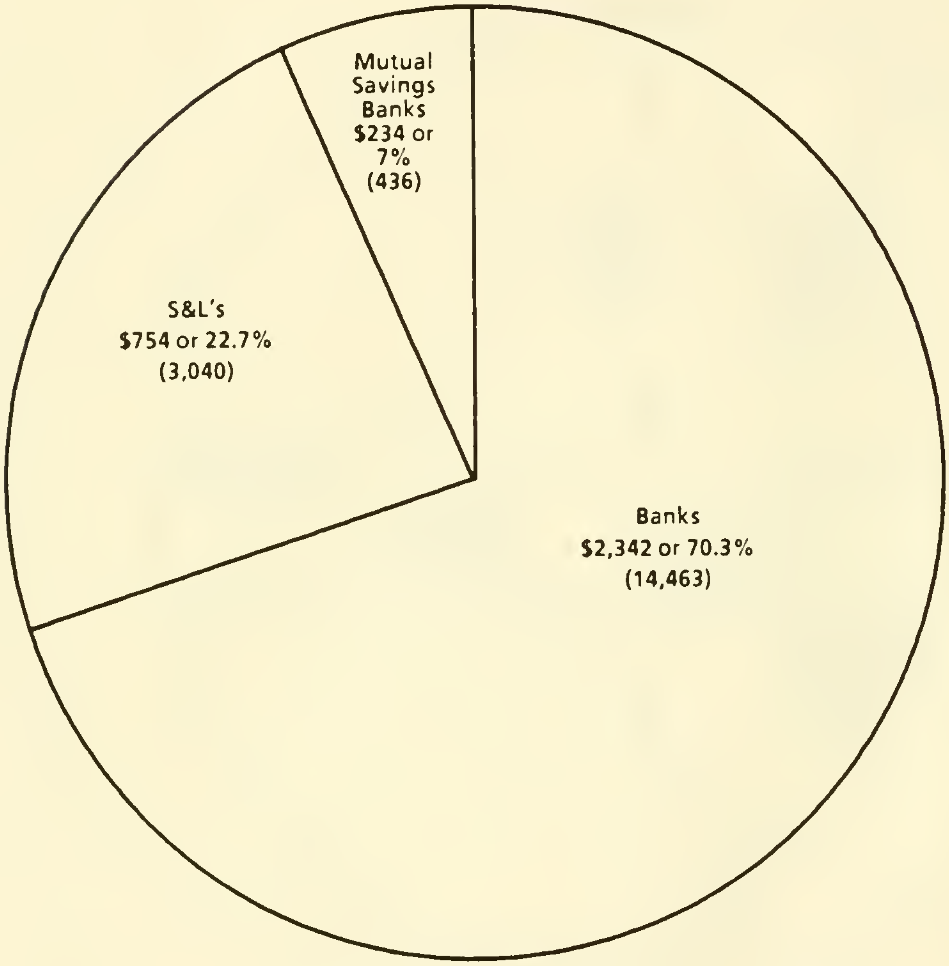
Total Thrifts = 3,476
Total Assets = $988 billion
(Includes Mutual Savings Banks)

FIGURE 16

Distribution of Assets

and Numbers of All Banks and Thrifts Combined

(As of 12/31/83; $ in billions)

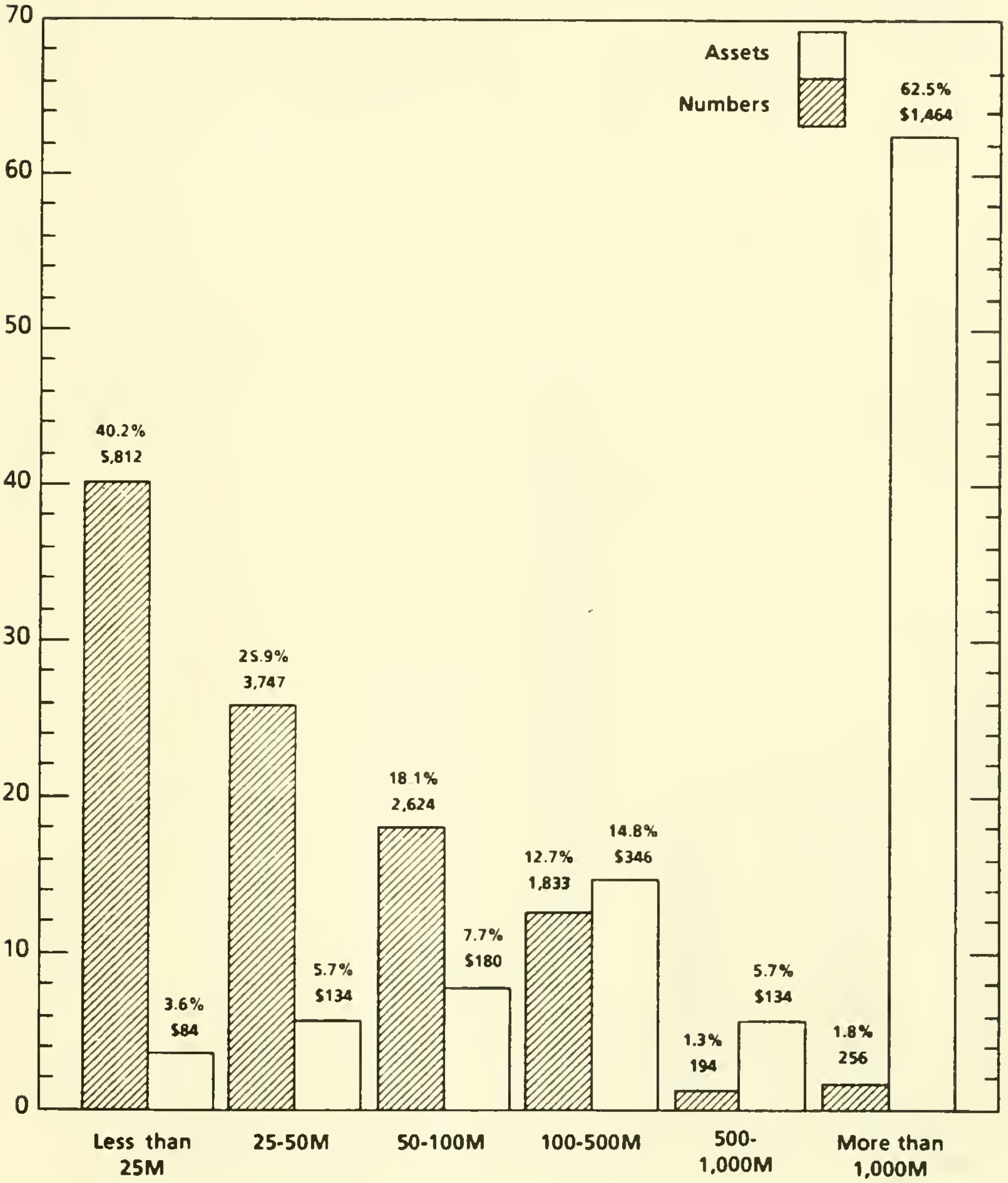


Total Institutions = 17,939
Total Assets = $3,330 billion

FIGURE 17

Percentage Distribution of the Number of Banks and Their Assets by Asset Size

(As of 12/31/83; $ in billions)

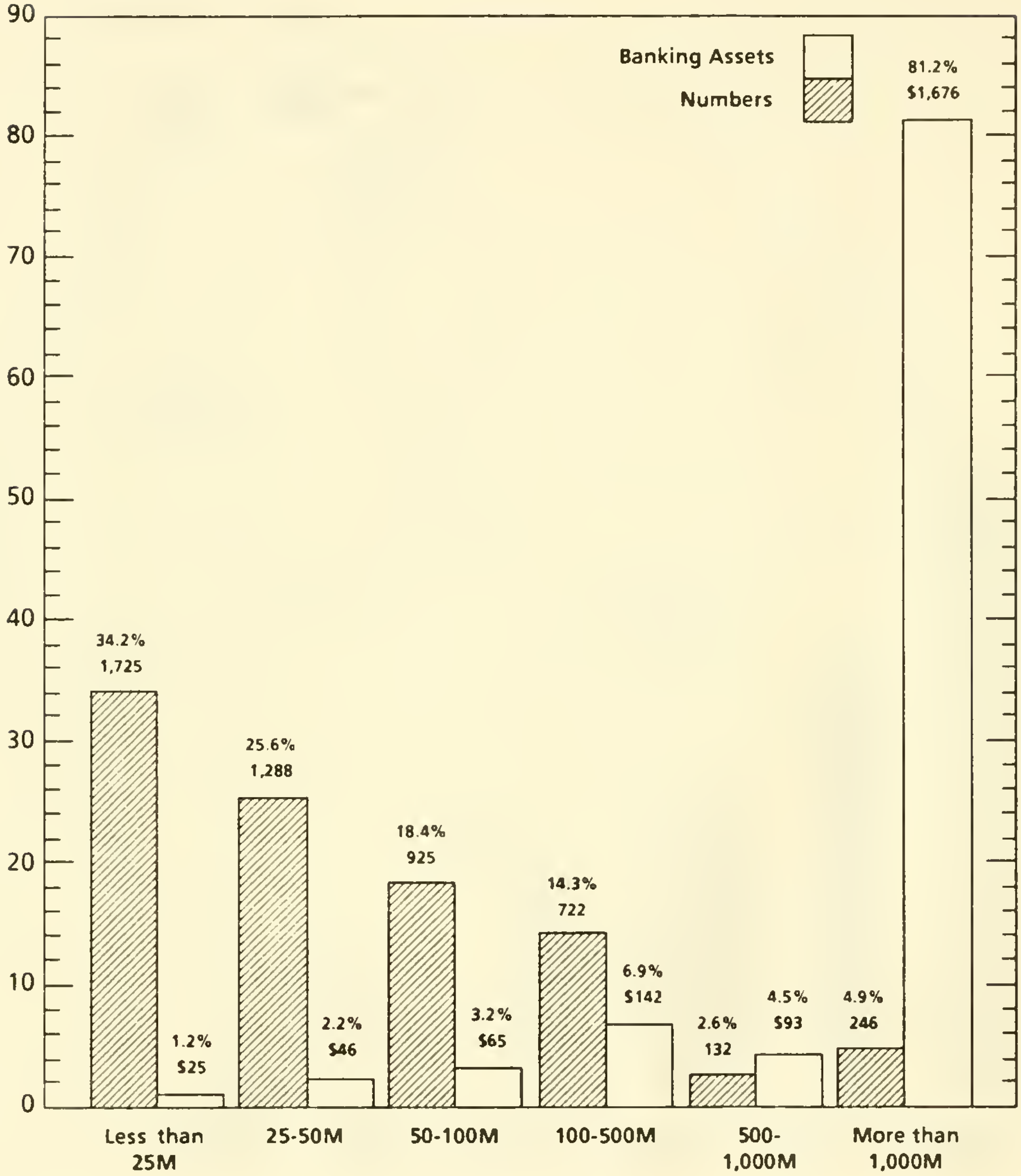


Total Banks = 14,463   Total Assets = $2,342 billion   (Excludes Mutual Savings Banks)

FIGURE 18

Percentage Distribution of the Number of Bank Holding Companies and Their Banking Assets by Asset Size

(As of 12/31/83; $ in billions)



Total Bank Holding Companies = 5,038

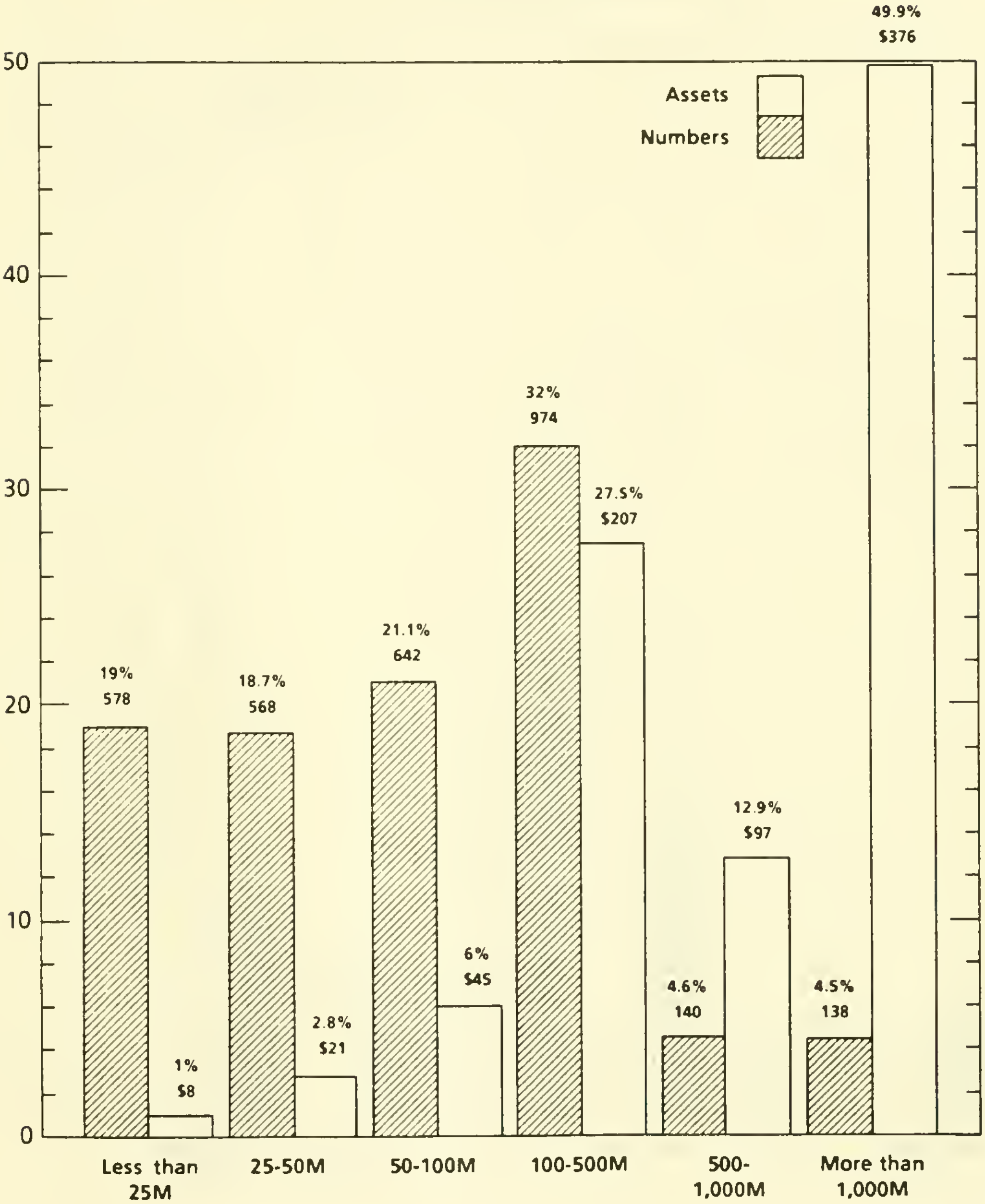
(excludes tiered holding companies)

Total Banking Assets = $2,047 billion

FIGURE 19

Percentage Distribution of the Number of Thrifts and Their Assets by Asset Size

(As of 12/31/83; $ in billions)

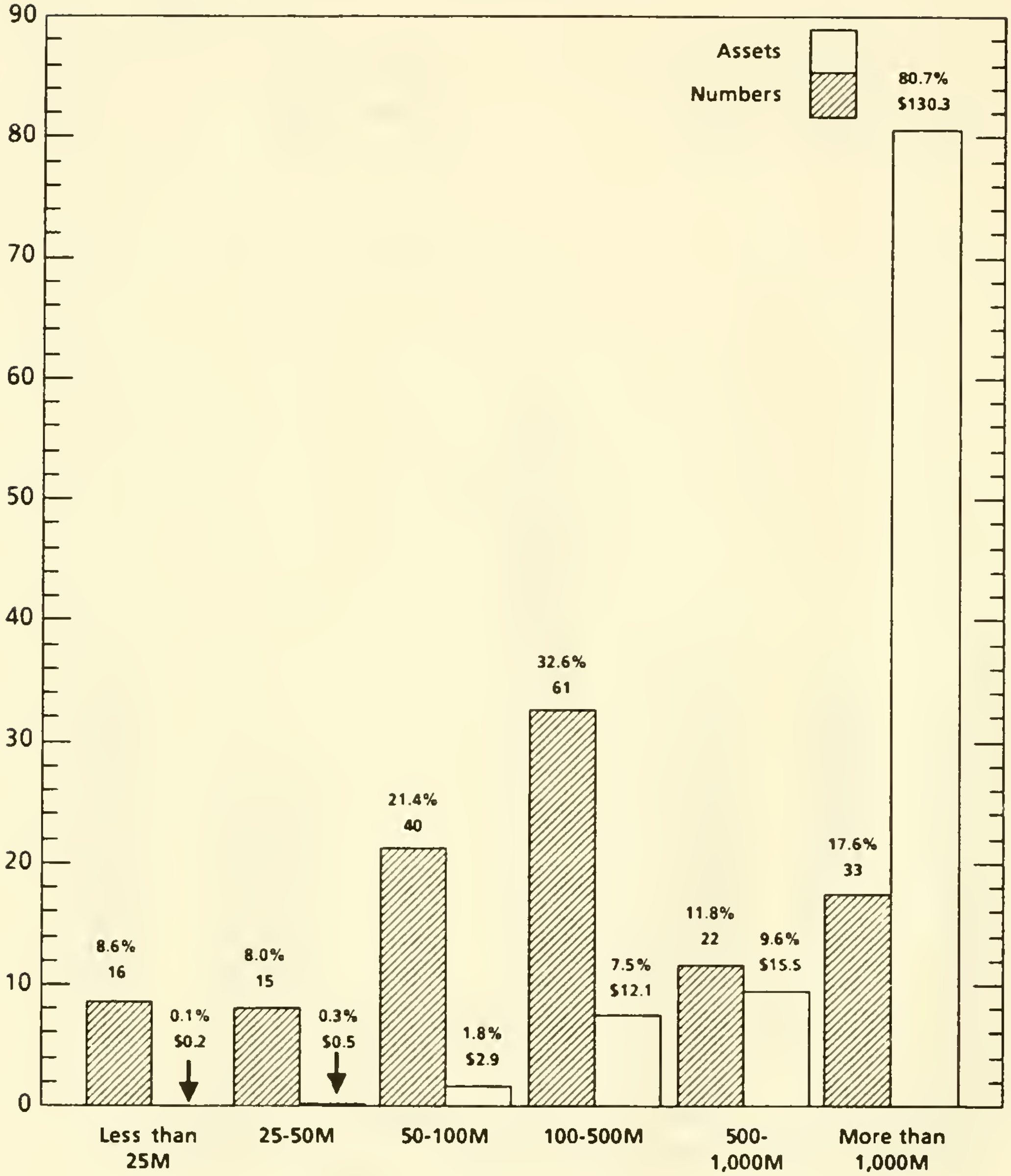


Total Thrifts = 3,040 Total Assets = $754 billion (excludes Mutual Savings Banks)

FIGURE 20

Percentage Distribution of the Number of Thrift Holding Companies and Their Assets by Asset Size*

(As of 12/31/83; $ in billions)



Total Thrift Holding Companies = 187 Total Assets = $161.5 billion (excludes tiered holding companies)

* Data estimated by Federal Home Loan Bank Board

APPENDIX B

Recommendations to Reduce Excessive Regulation

A. Statutory/Regulatory Controls and Procedures

The following recommendations are aimed at the reduction of unnecessary statutory provisions which remain "on the books" of the Federal agencies as well as the reduction or simplification of the agencies' still-valid statutory/regulatory controls and procedures.

1. Amend 12 U.S.C. 1828(c) of the Federal Deposit Insurance Act to shift investigation of safety and soundness of an uninsured institution being merged with a national or state member bank from the FDIC to the state or Federal agency which will supervise the successor entity.

Explanation: The FDI Act at 12 U.S.C. 1828(c)(1) requires the FDIC to perform an investigation of an uninsured institution in connection with the merger or acquisition of that institution by a national or state member bank. Inasmuch as the OCC or the state authority will have direct supervisory responsibilities following the merger or acquisition, the investigation for safety and soundness-related issues should be shifted to the state or Federal agency which will have direct supervisory responsibilities following the merger. A separate approval by the Department of Justice (DOJ) would be required, solely as relates to the competitive factor. DOJ would be the sole Federal regulator with respect to the competitive portion of the merger process. 12 U.S.C. 1828(c)(1) would be eliminated as a result and 12 U.S.C. 1828(c)(2) would be slightly modified to cover mergers with both insured and uninsured banks.

2. Amend 12 U.S.C. 1814(b) of the Federal Deposit Insurance Act to eliminate the need for the FDIC to consent to the continuation of the insured status of a state member bank changing to nonmember status and to provide for the automatic continuation of insurance in such an instance.

Explanation: The FDI Act at 12 U.S.C. 1814(b) provides that deposit insurance continues in the event of an insured national bank converting to state nonmember bank status. At the same time the statute provides that the insured status of a bank will not continue for a state member bank changing to a nonmember status unless the FDIC consents to the continuation of the insured status. Since both situations include membership in the FRB, it is inconsistent to permit membership to be dropped without FDIC consent in one case but to require such consent in the other. No reason is evident to require it in either case.

3. Amend 12 U.S.C. 1828(i) of the Federal Deposit Insurance Act to remove reference to retirement of capital notes and debentures from the requirement of prior FDIC approval of insured nonmember banks' reducing or retiring such notes and debentures.

Explanation: The FDI Act at 12 U.S.C. 1828(i) requires insured nonmember banks to obtain the FDIC's prior approval to reduce or retire "capital" notes or debentures. Originally designed to preserve a bank's capital structure, this provision does not give practical recognition to the fact that notes and debentures are liabilities and not capital. On December 17, 1981, the FDIC adopted a policy statement to the effect that notes and debentures will no longer be taken into consideration in determining the capital adequacy of a bank. Accordingly, reference to retirement of capital notes and debentures should be removed from the provisions of the Act because the procedures through which banks and the FDIC are forced to go for the purpose of retiring debt serve little or no purpose.

4. Amend 12 U.S.C. 1817(j) of the Federal Deposit Insurance Act to permit regulatory agencies to exclude from the expensive and time-consuming application process stock control changes within the family, or those that represent an interim step preceding the establishment of a bank holding company (BHC).

Explanation: The FDI Act at 12 U.S.C. 1817(j) contains important provisions which prevent stock control changes that are or may prove to be detrimental to the bank and its depositors. However, the provisions have serious drawbacks in two respects: The provisions include transactions which apparently should have been omitted, and they require a duplication of work in many instances. With regard to the excessive scope of the provisions, many of the required "Notices of Acquisitions of Control" relate to transfers within a family whereby a father or an estate transfers control to a son or relative. The statute should be modified to allow the regulatory agencies to exclude this type of transaction from the expensive and time-consuming application process. In many instances, a change in control may represent an interim step that precedes the establishment of a bank holding company. In such instances the FDIC's investigation of the interim control step needlessly duplicates the FRB's subsequent approval process. The misuse of resources can also be corrected by providing the agencies with administrative flexibility to exclude transactions from the application of the statutory provisions.

5. Amend 12 U.S.C. 1829 of the Federal Deposit Insurance Act to waive the application and consent requirement for persons with criminal convictions who seek employment with an insured bank after the FDIC has previously consented to their employment elsewhere.

Explanation: Any person with a prior conviction involving dishonesty or breach of trust is required by 12 U.S.C. 1829 to obtain the FDIC's prior consent before being employed by an insured bank. This provision of the FDI Act has two weaknesses. In the first instance, a minor offense committed in years past will require repeated application filings every time such a person takes a job at a different bank. Not only does the statute require an unreasonable duplication of effort to retrace data which has previously been cleared but it needlessly subjects the applicant to humiliating experiences. The statute should be amended by providing flexibility to waive the requirement to file bank applications once consent has been granted.

6. Amend 12 U.S.C. 1829 (see above) to cover employment with the parent holding company.

Explanation: Another deficiency in 12 U.S.C. 1829 is that the application provision does not extend to employment of a convicted person by a holding company. Because persons in key positions within the holding company can influence bank policy and practices and also since it is not clear whether an order could be adopted under the enforcement powers of the FDIC to reach a person holding a position in the holding company, it would appear that 12 U.S.C. 1829 should be extended to embrace employment with a holding company.

7. Amend the National Historic Preservation Act to eliminate the necessity of a determination by Federal banking agencies, in addition to state determination, that a bank's relocation, new branch, or establishment meets certain eligibility requirements.

Explanation: The subject Act requires Federal agencies, with respect to any approvals or issuances of licenses for an "undertaking," to take into account the effect of the undertaking on any site, building, etc., that is included or is eligible for inclusion in the National Register of Historic Places. An affirmative agency determination is required based on either a listing in the National Register or on criteria established by the National Council which would indicate possible eligibility for inclusion. Similar determinations must be made by the bank and the State Historical Preservation Officer. The principal problem is one of delay and duplication. Upon receiving an application the Agency must "consult" with the State Historic Preservation Officer who has 30 days to respond before the agency may act on the application. If potential eligibility is involved a much longer process ensues. Since the banking agencies possess little or no expertise in this area and since the process is duplicative, the banking agencies should be relieved of this responsibility. Financial institutions could, alternatively, be simply advised of their responsibility to notify the State Historic Preservation Officer thereby reducing some delay in having an application considered.

8. Amend the National Environmental Policy Act to eliminate the necessity of determinations by the Federal banking agencies about whether the establishment of new banks, branches, mergers, relocations and facilities will significantly affect the environment.

Explanation: The subject Act requires Federal agencies to make a determination as to whether or not their actions would have an effect on the quality of the human environment. Where such a determination is made the agency is required to file a detailed Environmental Impact Statement with the Council on Environmental Quality and observe certain designated time schedules for review and public availability of the statement prior to final agency action. Since application for branches, new banks, relocations, etc., must meet local zoning codes it is unusual that adverse environmental impact will occur. For banking offices any adverse impact, should it occur, would probably be best resolved at the local, rather than the Federal, level anyway. Requiring the Federal banking agencies to make determinations increases the potential for substantive delays. If Federal action is necessary it would seem best handled by simply instructing a bank to communicate its plans directly to the Environmental Protection Agency.

9. Repeal the first three paragraphs of Section 8 of the Clayton Act (15 U.S.C. 19) which prohibit management and employee interlocks between a member bank and other banks located in certain geographic areas.

Explanation: This prohibition was duplicated and expanded on by the Depository Institutions Management Interlocks Act ("DIMIA"), enacted in 1978 as part of FIRA (12 U.S.C. 3201, *et seq.*). DIMIA prohibited management interlocks among all deposit-taking institutions and expanded the geographic scope of the prohibition according to the size of the institutions involved in an interlock. In light of the 1978 enactment of DIMIA, and certain technical inconsistencies between Clayton and DIMIA, retention of the first three paragraphs of Section 8 of the Clayton Act is excessive.

10. Give the Securities Exchange Commission broad authority to grant exemptions from the registration requirements of the Securities Act of 1933 for those securities or securities transactions for which full registration is unnecessary.

Explanations: The SEC deals with a variety of situations in which registration under the Securities Act is neither necessary nor desirable. In many of these cases, it may not be entirely clear whether a statutory exemption is available. An example of this is bank pre-organization certificates that are sold to meet the minimum capital requirements set by bank regulatory agencies. The sale of certain types of securities issued by foreign issuers (e.g. certificates of deposit issued by a U.S. branch of a foreign bank that is regulated by a federal or state banking agency) is another case in point. Blanket exemptive authority would allow the SEC maximum flexibility in dealing with these types of situations, as it possesses under both the Investment Company Act and Investment Advisers Act. Section 303 of the Federal Securities Code adopted by the American Law Institute contains a provision very similar to the SEC's proposal for blanket exemptive authority and provides an excellent framework for legislative drafting purposes.

11. Combine 12 U.S.C. 31 and 32 with 12 U.S.C. 30.

Explanation: 12 U.S.C. 31 and 32 relate to the rights and liabilities of a national bank that changes its name or location. 12 U.S.C. 30 deals with the same subject. Combining these statutes would make for a less confusing statutory framework.

12. Combine 12 U.S.C. 40 and 41 with 12 U.S.C. 42.

Explanation: 12 U.S.C. 40 and 41 extend the national banking laws to the Virgin Islands and Guam. 12 U.S.C. 42 deals with the territorial application of the national banking laws. Combining these statutes would make for a less confusing statutory framework.

13. Repeal 12 U.S.C. 87, 88 and 89, which govern circulating notes issued by national banks.

Explanation: These statutes are obsolete since national banks no longer issue such notes.

14. Repeal 12 U.S.C. 101-109, 121-126, 131-138, and 195.

Explanation: These statutes, which govern a national bank's issuance, replacement, redemption and failure to redeem its circulating notes, are obsolete insofar as the Comptroller of the Currency is involved in the process and should be repealed.

15. Repeal 12 U.S.C. 168-178 and 183-186.

Explanation: These statutes, which govern the deposit and return of U.S. Bonds that back a national bank's circulating notes, are obsolete insofar as the Comptroller of the Currency is involved in the process and should be repealed.

16. Revise 12 U.S.C. 214, 214a, 214b, 214c, 215, 215a, and 215b in order to facilitate the reorganization of national banks.

Explanation: These statutes need revision to facilitate the reorganization of national banks without the need to form an "interim" or "phantom" bank. At present, a national bank wishing to reorganize the ownership of its shares must go through the confusing, time-consuming and expensive process of seeking a charter for a bank that will exist only on paper and only for a short period of time. This procedure is used in two situations: when a bank wants to convert itself into a wholly-owned subsidiary of a newly formed bank holding company and when an existing holding company want to acquire 100% of the stock of an independently-owned bank. In each case, management must apply to OCC both to form the new interim bank and to merge it with the existing bank. Upon consummation of the merger, all of the stock of the merged bank is acquired by the holding company, and the bank shareholders who dissented from the merger are paid and their shares auctioned. This procedure would be simplified by a new statute authorizing the holding company's direct acquisition of 100% of the bank's stock, without the need to charter a new bank and engage in a merger. Dissenting shareholders would still be entitled to the value of their shares, but OCC's role in the appraisal of the share's value would be eliminated in favor of allowing shareholders to resort to court action if not satisfied with the appraisal reached by a committee of three private individuals.

17. Revise 12 U.S.C. 72 to eliminate the requirement that most national bank directors must have resided in the bank's community prior to appointment. The number of directors who must comply with the residency requirement (i.e., living within 100 miles from the bank's main office or within the state in which the bank is located) should be reduced from two-thirds to a majority.

Explanation: As executive mobility and commuting increase there is less reason to differentiate between banks and other operations by requiring directors to have lived in the area where the bank is located for one year prior to the bank's organization. The same argument supports reducing to a simple majority (from two-thirds) the number of directors who must comply with the residency requirement. Revising the statute in this respect will not significantly detract from its original objective of assuring a sizeable number of local directors for each national bank while it will facilitate the recruitment of high-quality directors.

18. Revise 12 U.S.C. 418-420 to give the Secretary of the Treasury, rather than the Comptroller of the Currency, authority over the engraving and custody of plates, printing, and delivery of Federal Reserve notes to the Federal Reserve Banks.

Explanation: The responsibility for printing the national currency is no longer consistent with the Comptroller's duties as a regulator of a national bank and is, in fact, performed by other Treasury bureaus. Accordingly, these functions should be transferred to the Secretary of the Treasury for appropriate delegation elsewhere within the Treasury Department. This could be achieved by transferring such authorities to 31 U.S.C. 5114, which gives the Secretary general authority for engraving and printing of United States Currency.

19. Repeal or reduce the reporting requirements of Titles VIII and IX of the Financial Institutions Regulatory and Interest Rate Control Act of 1978.

Explanation: Titles VIII and IX of the Financial Institutions Regulatory and Interest Rate Control Act of 1978 require the submission of reports which should be discontinued. Title VIII requires certain shareholders, directors and officers of a bank to file detailed information with the bank each year pertaining to credit that the individual has received from a correspondent of the bank. Additionally, an insured nonmember bank is required to submit a consolidated report to the FDIC based on the individual reports submitted to the bank while FRB member banks would submit such reports either to the OCC or to the FRB.

Title IX requires a bank to report information about principal shareholders annually and to make the information publicly available. Based on the regulatory agencies' experience, the practical utility of these reporting systems does not justify the burdens they impose. The regulators rely upon routine examination procedures to detect abuses associated with correspondent relationships and to ascertain pertinent information pertaining to major stockholders. There has not been detected any interest by the public to obtain Title IX information. Of note is the Garn-St Germain provision concerning these reports and related inter-agency discussions that are taking place. Because these reports neither assist the regulators nor attract any apparent interest from the public, the reporting requirements should be removed from the statutes or the burden of the reports ought to be significantly reduced.

20. <u>All provisions required or permitted by the Trust Indenture Act to include in a trust indenture should be permitted to be incorporated by reference</u>.

<u>Explanation</u>: The Act currently does not provide for incorporation by reference. Adoption of this recommendation would reduce paperwork, facilitate drafting of trust indentures, and avoid legal problems where the provisions of an indenture conflict with the provisions in the Act.

21. <u>The annual report required of a trustee under the Trust Indenture Act that the trustee remains qualified to act as trustee should be eliminated in favor of reports only when a trustee becomes unqualified</u>.

<u>Explanation</u>: It is rare for trustees to become unqualified to continue to act as trustee. Consequently, by changing the current requirement of an annual report that the trustee <u>is</u> qualified to a periodic report if the trustee <u>is</u> <u>not</u> qualified would reduce the paperwork burden on the private sector.

22. <u>The SEC and the CFTC should continue to coordinate regulatory requirements of the two agencies that affect entities registered with or regulated by both agencies</u>.

<u>Explanation</u>: The two agencies have a large number of individuals subject to dual registration with <u>both</u> the SEC and CFTC. Consequently, the agencies should continue efforts to fashion complementary registration systems, to eliminate dual fingerprinting, and to share data for background investigations. Legislation should be enacted to express Congressional policy to promote common procedures where practicable, and to facilitate elimination of the need for dual fingerprint submissions.

23. Eliminate duplicate forms or registration for broker-dealers acting as investment advisers.

Explanation: Under current law, broker-dealers registered with the SEC must frequently also register a second time with the SEC as investment advisers. This duplication should be eliminated for SEC-registered broker-dealers. This could be done simply by providing a single registration form for broker-dealers and investment advisers.

24. Eliminate investment adviser controls on individuals engaged in generic financial planning.

Explanation: Under current law, financial planners who give generic portfolio composition advice (e.g., X% bank deposits, X% insurance, X% securities) but do not give advice regarding, or receive compensation from the sale of, specific products, or have discretionary control over client funds, must nonetheless register as investment advisers under the Investment Advisers Act because of the broad scope of the definition of investment advisers under that Act. Persons who limit their activities to generic advice of the kind described are not within the intent of the Act, especially because they are not likely to commit any of the abuses the Act was designed to prevent. Therefore, such financial planners should not be required to register under the Act.

25. Eliminate restrictions against mutual funds purchasing shares of certain financial firms.

Explanation: Current outmoded blanket restrictions in the Investment Company Act against purchases by investment companies of shares of broker-dealers, investment advisers, and the parent firms thereof (e.g., Sears, Prudential Insurance, American Express) should be repealed. These restrictions are outdated now that securities of such issuers are widely traded, and much information is available about their businesses and financial condition. Also the SEC has substantial experience in regulating broker-dealers and investment advisers. This was not the case in 1940 when the restrictions were enacted. To prevent pyramiding, limits could be placed on the amount of broker-dealer and investment adviser shares that an investment company could own. In addition, to deal with conflicts of interest, acquisition of securities issued by affiliated persons could be prohibited or subjected to other limitations.

26. Streamline the exemption process under the Investment Company Act of 1940.

Explanation: The process of granting exemptions under the Investment Company Act should be streamlined to remove the requirement for public notice and comment in every case. Most exemptions are not controversial and are amply supported by precedent. Publication of notice seldom elicits any responses. Removing the notice requirements would eliminate unnecessary delays in the regulatory process and reduce costs and paperwork burdens.

APPENDIX C

Description of Certification Program

1. Under new procedures, states would be able to seek "certification" to assume specific federal supervisory responsibilities for state-chartered banks or their holding companies, either in whole or in part. For example, certification could apply to responsibilities for:

a. Enforcement or examination, as well as supervision; or

b. Certain types of issues (e.g. safety and soundness reviews; consumer or other federal banking statutes; certain types of bank holding company supervision, etc.).

2. Certification could also vary depending on the type of banks covered. For example, certification could apply to banks below a certain size, banks without foreign activities, non-member banks, etc. Certification could also cover supervision of different types of bank holding companies where the lead bank is a state-chartered institution.

Schedule I describes possible certification options in greater detail.

3. The certification program would be kept as flexible as possible, with federal authorities under statutory direction to transfer responsibilities to the state[1] to the maximum degree practicable and prudent. To the extent states are certified, state authorities would exercise designated authorities for the specified type or size of institutions, subject to the residual regulatory authority and oversight of the FRB and insurance authority of the FDIC. This residual authority would include monitoring of state systems to enforce compliance with federal laws.

4. Regulations establishing criteria for different "levels"[2] of state certification would be adopted by a majority vote of a committee consisting of the FBA, FRB and FDIC. The FRB, in consultation with the FBA and FDIC, would act on specific state applications to become certified and would determine the level of certification. The FRB and each individual state would agree on provisions for FRB oversight. The FDIC could veto any certification for a state prior to approval by the FRB (and it

---

[1]Such a transfer would, however, not go beyond a state's request.

[2]As used herein, the "level" of certification means such things as the size or type of institution covered by certification, either in terms of total assets or other factors.

could recommend revocation of certification at any time) where it determined undue risks to the insurance fund might be involved.

5. Before states could be eligible for certification of holding company supervision, the state would be required to adopt the BHCA or a statute with provisions not less stringent than the BHCA (as amended by FIDA).

6. In supervising state holding companies state authorities would be bound, both initially and on an ongoing basis, by (i) the FBA laundry list and implementing regulations, and (ii) the joint prudential standards of the FBA and FRB.

7. Certification standards for holding company regulation could include such factors as state capability to supervise out-of-state holding company activities and the aggregate size of holding companies under state supervision (e.g. up to $500 million in assets or with solely intra-state non-banking activities).

8. The FRB would be entitled to review all holding company applications submitted to state authorities in a certified state. The FRB could comment to state authorities on policy or legal issues and would retain the right to disapprove decisions inconsistent with federal law or regulations.

9. The FRB would maintain an oversight role and a right to challenge (and disapprove) state interpretations of the BHCA that are not consistent with those of the FBA or FRB.

10. All certifications would be subject to periodic renewal (e.g. every 4-5 years), but the FRB would have the authority at any time to limit or rescind certifications then in force due to material changes in state supervisory programs or other relevant circumstances. In the event the FRB decided to limit or revoke a state's certification it would promptly notify the FBA and FDIC of its actions.

Examples of Possible Levels of Certification[3]

In addition to those supervisory and regulatory functions which may be immediately transferred to the States, the following might also be done.

Illustrative "First Level" certification

1. Exclusive performance of onsite examinations for banks under a specified asset size (e.g. $150 million).

2. Primary responsibility for prudential standards for banks under a specified asset size (e.g. $150 million).

3. Small intra-state holding company applications (under a specified asset size, e.g. $150 million assets total), for activities on list and within capital guidelines for bank holding companies.

4. Alternate year examination or other cooperative arrangements for large banks.

5. Presumption to state comment on bank safety and soundness and managerial considerations on applications under the BHCA for holding companies below a specified asset size (e.g. $150 million).

Illustrative "Second Level" certification

1. All intra-state mergers within capital guidelines.

2. All onsite examinations, with FRB presence in banks with assets over $500 million.

3. State determination of applications under the BHCA involving larger holding companies (e.g. up to $500 million).

4. Primary enforcement of FIRA and 23A.

[3] Both bank and holding company responsibilities transferred to the states under the certification program would be subject to the residual federal oversight and authority described herein.

☆ U.S. GOVERNMENT PRINTING OFFICE: 1984-457-822:20329